Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1993

PAUL G. SCHMIDT, PAULINE B. SCHMIDT, PAUL A. SCHMIDT AND THE ACRO CORPORATION, *Petitioners*

v.

MIKE ESPY, SECRETARY, UNITED STATES DEPARTMENT OF AGRICULTURE, *Respondent*

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

I. WHETHER CERTIORARI SHOULD BE GRANTED IN THIS CASE, PURSUANT TO RULE 10.1(C) OF THE SUPREME COURT RULES, SO THAT THE PROPER INTERPRETATION OF THE "GOOD FAITH" REQUIREMENT OF 7 C.F.R. §1951.911(a)(4)(i) (1992) (PRESERVATION LOAN SERVICING PROGRAMS: LEASEBACK/-BUYBACK) CAN BE SETTLED BY THIS COURT, IN LIGHT OF THE EIGHTH CIRCUIT COURT OF APPEALS' DECISION BELOW.

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PETITION FOR WRIT OF CERTIORARI

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioners, Paul G. Schmidt, Pauline B. Schmidt, Paul A. Schmidt, and the Acro Corporation, respectfully pray that a Writ of Certiorari issue to review the Judg-

ment of the United States Court of Appeals for the Eighth Circuit entered on November 19, 1993 and set forth in the Appendix at page A-4.

OPINIONS BELOW

A. Appellate Court

The November 19, 1993 Opinion of the Eighth Circuit Court of Appeals is reported at 9 F.3d 1352 (8th Cir. 1993) and is set forth in the Appendix at pages A-4 through A-8. The appellate court affirmed in part and reversed in part the Judgment of the District Court.

B. Federal District Court

The January 27, 1993 Opinion of the United States District Court for the Western District of Arkansas, the Honorable H. Franklin Waters presiding, is set forth in the Appendix at pages A-11 through A-24. This Opinion was filed for record on February 1, 1993, and it upheld the U.S.D.A.'s adverse ruling on Petitioners' Application for Lease/Buyback Loan Servicing through the Farmers Home Administration.

The January 8, 1993, Summary Judgment Opinion and attendant Findings of Fact were filed by the Federal District Court on January 11, 1993, and appear in the Appendix at pages A-24 through A-30.

The November 10, 1992, Motion Ruling/Letter

Opinion of the United States District Court is set forth in the Appendix at pages A-31 through A-40, and bears a November 12, 1992, file mark.

C. Administrative Agency

The July 7, 1992 Letter Opinion of the Farmers Home Administration National Appeals Staff, rendered by Director Frederick R. Young, is set forth in the Appendix at pages A-41 through A-43. In its Opinion Letter, the FmHA determined that the decision by the County Supervisor to deny Petitioners' Application for Leaseback/Buyback should be upheld.

The May 6, 1992, Letter Opinion of the Farmers Home Administration State Director, rendered by Robert L. Hankins, is set forth in the Appendix at page A-44. It, too, upheld the County Supervisor's denial of Petitioners' entitlement to Leaseback/Buyback Preservation Loan Services under 7 C.F.R. 1951.911(a) (1992).

The March 5, 1992, Letter Opinion of the Farmers Home Administration National Appeals Staff, rendered by Hearing Officer Thomas W. Anthony, Jr., and upholding the County Supervisor's adverse ruling, is set forth in the Appendix at pages A-45 through A-50.

The December 3, 1991, Letter Opinion of the County Supervisor denying Petitioners' Request for Leaseback/Buyback Loan Servicing is set forth at pages A-51

through A-52 of the Appendix.[1]

JURISDICTIONAL STATEMENT

The Judgment of the United States Court of Appeals for the Eighth Circuit was rendered on November 19, 1993, and is set forth at page A-4 of the Appendix herein. Thereafter, Appellants filed a timely Petition for Rehearing, which was denied by Order of the Eighth Circuit Court of Appeals on December 28, 1993. That Order is set forth in the Appendix at page A-2.

The original jurisdiction of the Federal District Court was premised upon 18 U.S.C. §1331 (1982) (federal question) and 28 U.S.C. §§2201 and 2202 (1982) (declaratory judgment act).

The jurisdiction of the Eighth Circuit Court of Appeals was invoked pursuant to 28 U.S.C. §1291 (1982), and the jurisdiction of the Supreme Court of the United States is invoked under 28 U.S.C. §1254(1) (1988) to review the judgment of the Eighth Circuit.

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[1] Because the agency determination regarding Petitioners' Application for Primary Loan Servicing under 7 C.F.R. §1951.909 (1992) is also relevant, the June 8, 1990, Letter Opinion and Appeal Summary of the Farmers Home Administration National Appeals Staff is set forth in the Appendix at pages A-52 through A-55, and the August 15, 1989, Letter Opinion of the Farmers Home Administration State Director is set forth in the Appendix at page A-65.

TIMELINESS OF FILING

Pursuant to Rule 20.1 of the Rules of the Supreme Court of the United States, this Petition is being brought in timely fashion, since Petitioners moved for and were granted an extension of time in which to file this Petition. A copy of the Order extending the filing time through April 27, 1994, is attached at page A-1 of the Appendix. The February 22, 1994, Order was signed by Justice Harry A. Blackmun and was filed for record on the same date.

CONSTITUTIONAL PROVISIONS AND FEDERAL REGULATIONS

The constitutional provisions involved in this case are the Fifth Amendment, which provides that "[n]o person . . . shall be deprived of life, liberty, or property, without due process of law," and the Fourteenth Amendment to the United States Constitution, which provides that no State shall "deprive any person of life, liberty, or property, without due process of law." The full text of the Fifth Amendment to the United States Constitution is set forth at page A-70 of the Appendix, and the full text of the Fourteenth Amendment is set forth at page A-70 of the Appendix.

The Federal Regulation under which Petitioners assert their entitlement to Leaseback/Buyback of their farmland is 7 C.F.R. §1951.911(a)(4) (1992), which describes the eligibility requirements for this particular Preservation Loan Service Program under the Agricultur-

al Credit Act of 1987. Pub. L. No. 100-233, 101 Stat. 1586 (1987 Act). The full text of this regulation is set forth at pages A-67 through A-69 of the Appendix.

STATEMENT OF THE CASE

A. Course of Proceedings

On March 10, 1989, Petitioners requested to be considered by the Farmers Home Administration for Primary and Preservation Loan Servicing concerning their family farmland. (See Appendix at Page A-64). In connection therewith, on April 14, 1989, Petitioners submitted their Applications for Primary Loan Servicing, Homestead Preservation Loan Servicing, and Leaseback/Buyback Preservation under 7 C.F.R. §1951.906 (1993) (defining FmHA loan servicing programs); 7 C.F.R. §1951.909 (1992) (processing primary loan service programs requests); 7 C.F.R. §1951.911(a) (1992) (preservation loan service programs: leaseback/buyback); and 7 C.F.R. §1951.911(b) (1992) (preservation loan service programs: homestead protection).[2] See also page 1 of the Eighth Circuit Court of Appeals November 19, 1993, Opinion (Appendix at page A-4.)

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[2] It is Petitioners' denial of eligibility for the Leaseback/Buyback Preservation Loan Service Program which is at issue in this Petition for Writ of Certiorari. Specifically, the Eighth Circuit Court of Appeals, in its November 19, 1993, Opinion, reversed the FmHA's denial of Petitioners' Application for Homestead Preservation Loan Servicing and remanded that portion of the case for further consideration. See Appendix at pages A- through A-. Schmidt v. U.S.D.A., 9 F.3d 1952 (8th Cir. 1993).

On April 10, 1990, Respondent purchased Petitioners' farmland by outbidding them at a judicial sale. It is this farmland which is the subject of Petitioners' Application for Leaseback/Buyback Preservation Loan Service in the instant case. 7 C.F.R. §1951.911 (1992).

On December 3, 1991, the FmHA County Supervisor declared petitioners ineligible to apply for Primary Loan Servicing and Leaseback/Buyback Preservation of their farmland (See Appendix at pages A-51 through A-52).

On July 7, 1992, the National Appeals Staff Director upheld FmHA's denial of Petitioners' application for Preservation Loan Servicing (Leaseback/Buyback) under the Agricultural Credit Act of 1987. 7 U.S.C. §§1981 *et seq.* (1992). This denial was based upon a finding that Petitioners had acted in bad faith in disposing of certain loan collateral. This denial by the National Appeals Staff was Petitioners' final administrative review of the determination that they were ineligible to apply for Leaseback/Buyback Loan Servicing.

On September 29, 1992, Petitioners filed an action for declaratory judgment in the United States District Court for the Western District of Arkansas, seeking relief against the Secretary of Agriculture. Specifically, Petitioners alleged that the Farmers Home Administration's determination that Petitioners were ineligible to apply for loan servicing plans under the Agricultural Credit Act of 1987, 7 U.S.C. §§1981 *et seq.* (1987), denied them their

rights and property without due process of law, in violation of the United States Constitution. Petitioners also asserted that the Farmers Home Administration's actions were in violation of the Food Security Act, as well as the Unites States Department of Agriculture's implementing regulations.

On October 13, 1992, Respondent filed a Motion to Dismiss which was denied by the Federal District Court on November 10, 1992, by an Order which was filed on November 12, 1992. (See Appendix at page A-31.)

On December 11, 1992, Respondent filed a Motion for Summary Judgment; thereafter, on January 11, 1993, Respondent's Summary Judgment Motion was denied by the Federal District Court, by an Order which was filed on the same date. (See Appendix at page A-24.)

On January 27, 1993, the District Court Judge issued a letter Opinion wherein the court upheld the FmHA's denial of Petitioners' entitlement to Leaseback/Buyback Preservation Loan Service under 7 C.F.R. §1951.911 (1992). (See Appendix at pages A-10 through A-24.) The final Judgment which disposed of all the claims of the parties was entered by the United States District Court for the Western District of Arkansas on January 28, 1993, and was premised on the grounds that there existed substantial evidence to support the U.S.D.A.'s denial of Leaseback/Buyback Preservation Loan Servicing to Petitioners. (See Appendix at page A-11.)

On February 8, 1993, Petitioners filed a Motion for New Trial or Amended Order, which was denied by the Federal District Court by Order dated February 19, 1993, and filed for record on February 22, 1993. (See Appendix at page A-8.) Thereafter, on March 10, 1993, Petitioners filed their Notice of Appeal to the Eighth Circuit.

The appellate court rendered its decision on November 19, 1993, wherein the Petitioners' appeal was affirmed in part and reversed in part. (See Appendix at pages A-4 through A-8.) Specifically, the Eighth Circuit Court of Appeals held that Petitioners were entitled to Homestead Protection, and the reviewing court remanded the case to the District Court with instructions to remand to the Secretary for further consideration of Petitioners' Application for Homestead Protection.

With regard to Petitioners' eligibility for participation in the FmHA Leaseback/Buyback Program, the appellate court upheld the U.S.D.A.'s finding of ineligibility. In so ruling, the Eighth Circuit noted a difference of opinion concerning the proper interpretation of 7 C.F.R. §1951.911(a)(4)(i) (1992) and (a)(4)(i)(A) (1992). (See Appendix at page A-7.) It is this conflict in interpretation and the need for clarification by the United States Supreme Court which underlies the Petition for Writ of Certiorari in the case at bar.

The basis for federal jurisdiction in the court of first instance was 28 U.S.C. §1331 (1982) (federal ques-

tion) and 28 U.S.C. §§2201 and 2202 (1982) (declaratory judgment act). Sovereign immunity was waived by 5 U.S.C. §§702–706 (supp. III 1985). Venue was proper pursuant to 28 U.S.C. §1391(e) (1982). Petitioners (the Schmidts) were Washington County, Arkansas, citizens and residents, and Petitioner Acro Corp. was a corporation doing business in Washington County, Arkansas. Respondent was the Secretary of Agriculture, who was ultimately responsible for all programs administered by the Farmers Home Administration, and all events alleged in Petitioners' Declaratory Judgment action before the Federal District Court for the Western District of Arkansas occurred in Washington County, Arkansas.

B. Material Facts

Petitioners Paul G. and Pauline B. Schmidt (the senior Schmidts) and their son, Petitioner Paul A. Schmidt, farm in Washington County, Arkansas. The senior Schmidts built their dwelling on the farm. Nearly twenty years ago, the family formed Acro Corporation to operate the farm. The senior Schmidts and their son each own half of the corporation, which they treat as a Sub-Chapter S Corporation for tax purposes. The senior Schmidts, their son, and the corporation (collectively the Schmidts) had Farmers Home Administration (FmHA) loans secured by livestock, equipment, the senior Schmidts' dwelling, and farm land. After the Schmidts breached their loan agreement, the FmHA notified the Schmidts it intended to call their loans. *Schmidt v. U.S.D.A.*, 9 F.3d 1952 (8th Cir. 1993).

On April 14, 1989, the Schmidts applied for Primary Loan Servicing, Leaseback/Buyback, and Homestead Protection. *See*, 7 C.F.R. §1951.906 (1993) (defining FmHA loan servicing programs). The FmHA County Supervisor denied the Schmidts' request for Primary Loan Servicing, finding that the Schmidts had improperly disposed of cattle pledged as collateral. (*I.e.*, "bad faith.") Several months later, the County Supervisor held the Schmidts' bad faith barred their request for Leaseback/-Buyback. The County Supervisor also held the senior Schmidts were ineligible for Homestead Protection because they did not receive any income from their farming operation. The County Supervisor's decisions were affirmed throughout the Department of Agriculture's administrative appeals process and by the District Court. *Id.*

On appeal, the Eighth Circuit upheld the FmHA's denial of Petitioners' application for Leaseback/Buyback loan servicing. However, the appellate court reversed the FmHA's denial of Homestead Protection to Petitioners, and remanded the case for further consideration of Petitioners' eligibility for that particular Preservation Loan Service program. (See Appendix at page A-8.)

With regard to the "bad faith" determination, Petitioners sold all their cattle on January 4, 1986, after receiving oral permission from the FmHA to do so. Moreover, Petitioners sent the entire proceeds of $32,064.90 to the FmHA for application on their loan. Thereafter on January 9, 1986, Petitioners received a letter from the FmHA County Supervisor wherein the Supervisor alleged

that Petitioners had improperly disposed of "twenty-three cows, one bull, and one yearling heifer or steer" without properly accounting for the proceeds from that sale. (See Appendix at page A-66.)

To refute this allegation, Petitioners explained and produced documentation to show that the "missing cows, yearling and bull" were simply a result of a mislabeled sales barn receipt from the January 4, 1986 transaction. Specifically, page one of that receipt showed that sixty-seven adult cattle were mislabeled as "calves," since the receipt showed the individual weights of those calves as ranging between seven hundred forty (740) pounds and one thousand one hundred sixty-two (1,162) pounds.[3] For example, line one of the sales barn receipt shows the sale of seven "calves," each weighing seven hundred forty pounds, while line twenty-five of the same receipt shows the sale of seven "calves," each weighing one thousand one hundred sixty-two pounds. Because it is physically impossible for a calf to weigh seven hundred forty pounds or over, Petitioners considered the sales barn receipt as sufficient proof to refute the County Supervisor's allega-

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[3] Relevant excerpts from the sales barn receipt in question show the following information:

No.	Tag #	Description	Buyer	Weight	Price
1	147	WF CLF 7HD	A5	740	52.25
4	150	WF CLF 7HD	A5	740	52.25
6	152	WF CLF 8HD	27	847	52.50
9	155	WF CLF 7HD	A5	740	51.25
15	161	WF CLF 14HD	A7	780	47.50
16	162	WF CLF	Nolan	870	28.50
19	165	WF CLF 8HD	27	874	52.50
22	168	WF CLF 8HD	27	874	52.50
25	170	WF CLF 7HD	27	1,162	50.00

tion of improper disposal of collateral, since the twenty-three cows in question were actually mislabeled as "calves" on the sales barn receipt, and since all of the proceeds from that sale had been delivered to the FmHA, thereby protecting the agency's security interest.

On this point, the FmHA County Supervisor's contemporaneous notes concerning Petitioners' case state, in pertinent part, "I will admit that it is possible that no cattle were converted. . . . It is conceivable that the sale barn could have listed some but not all cows as calves." Petitioners also produced documentation to account for the missing bull and yearling, thereby showing that the collateral in question had not been improperly liquidated.[4]

Based upon the County Supervisor's finding of "bad faith," Petitioners were denied Primary Loan Servicing through the FmHA, and they were also ultimately denied eligibility for Leaseback/Buyback Preservation Loan Servicing on the same grounds. Petitioners exhausted their administrative appeals, and subsequently brought a declaratory judgment action in the Federal District Court for the Western District of Arkansas.

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4. The formal notice to accelerate Petitioners' FmHA loans, dated February 27, 1989, also lists a failure to provide monthly cash flow statements as a reason for the acceleration. To counter this claim, Petitioners established that they had provided the FmHA with monthly cash flow statements and that petitioners were informed that those statements were acceptable. On this point, the Assistant County Supervisor's notes state, in part, as follows: "Bud in on 4/30/85. Brought cash flow showing deposits. Not in best schedule form but should be able to deciffere [sic] if he will remain cosist [sic] each month."

The United States District Court upheld the agency's adverse rulings on Petitioners' Primary (debt-structuring) and Preservation (Homestead Protection and Leaseback/Buyback) Loan Servicing Applications. Petitioners appealed this ruling to the Eighth Circuit Court of Appeals, which affirmed in part (Leaseback/Buyback) and reversed in part (Homestead Protection) the Federal District Court's decision.

It is from the appellate court's affirmance of Petitioners' denial of eligibility for Leaseback/Buyback Preservation Loan Servicing that Petitioners now seek to appeal under 28 U.S.C. §1254(1) (1988).

REASONS FOR GRANTING THE WRIT

I. CERTIORARI SHOULD BE GRANTED IN THIS CASE, PURSUANT TO RULE 10.1(C) OF THE SUPREME COURT RULES, SO THAT THE PROPER INTERPRETATION OF THE "GOOD FAITH" PROVISION OF THE FmHA'S LEASE-BACK/BUYBACK PRESERVATION LOAN SERVICE PROGRAM CAN BE ADDRESSED AND SETTLED BY THIS COURT.

The Farmers Home Administration was created in the 1930s to help meet the needs of the farm sector during the depression. S.Rep.No. 357, 101st Cong., 2d Sess. 238, *reprinted in* 1990 U.S.C.C.A.N. 4656, 3892. In fact, the Farmers Home Administration is "a lender of last resort for farmers who cannot obtain credit from private lenders." *Moseanko v. Yeutter*, 944 F.2d 418, 421 (8th Cir. 1991).

From the time of its inception, the FmHA has administered assistance programs to farmers, which programs have increased in size and scope over the years. In the 1980s, when farmland values declined, there was a resultant worsening of the farm economy. S.Rep.No. 357 at 237 through 238, 1990 U.S.C.C.A.N. at 4891-92. Thereafter, Congress passed the Agricultural Credit Act of 1987, Pub.L.No. 100-233, 101 Stat. 1586 (1987 Act), which governs debt restructuring and loan servicing for farmers and their families who qualify under the applicable federal regulations. *See*, 7 U.S.C. §2001 (1991).

Under the 1987 Act, the Secretary of Agriculture is directed to "modify delinquent farmer program loans . . . to the maximum extent possible . . . to avoid losses to the Secretary on such loans . . . and to ensure that borrowers are able to continue farming . . . operations." 7 U.S.C. §2001(a) (1991). Indeed, the purpose of the FmHA's loan servicing programs is "to keep the farmer on the farm and provide the best net recovery to the government." 7 U.S.C. §2001(a)(1) (1991); 7 C.F.R. §1951.902(a) (1992).

Under the Act, if an applicant is determined to be ineligible for one of the primary loan service programs *(i.e.*, rescheduling, re-amortization, and debt write-down), the borrower has a right to appeal and a right to buy the loan at net recovery value. *See*, 7 C.F.R. §1951.906 (1992) and 7 C.F.R. §1951.909(b) (1992).

If the borrower appeals, then FmHA will complete the appeal before it begins processing any request by the borrower for participation in one of the FmHA preservation loan service programs *(i.e.*, Leaseback/Buyback or Homestead Protection). *See*, 7 C.F.R. §1951.911(a) (1992) and 7 C.F.R. §1951.911(b) (1992).

The eligibility requirements for the Leaseback/-Buyback Program, which is at issue in the instant case, are set forth at 7 C. R.F. §1951.911(a)(4)(i) (1992), which provides as follows:

§1951.911 **Preservation Loan Service Programs.**

(a) **Leaseback/Buyback**

(4) *Eligibility.* The County supervisor will determine the applicant's eligibility.

(i) Any applicant for leaseback/buyback who either (1) first applied for primary servicing on or after November 28, 1990, or (2) first applied for leaseback/buyback on or after November 28, 1990, without first applying for primary servicing, and who is also the borrower/former owner, must have acted in good faith by demonstrating sincerity and honesty in meeting agreements set forth on form FmHA 1962-1 and agreements with FmHA.

(A) If a good faith determination has already been made in connection with the borrower/former borrower's request for primary servicing of his or her loan pursuant to §1951.909(c)(2), such determination will be binding on the borrower/former borrower's request for leaseback/buyback. . . .

NOTE: A good faith determination made prior to November 28, 1990, for primary servicing, which was based on the sole fact that the borrower disposed of normal income security before October 14, 1988, without FmHA consent, and it has been determined the proceeds were used for essential household and farm operating expenses of which the borrower would have

> been entitled to a release of income proceeds in accordance with §1962.17(b)(2)(iii) and exhibit E of subpart A of part 1962 of this chapter, such good faith determination will not be binding for a leaseback/buyback application filed on or after November 28, 1990.

The "good faith" requirement set forth in 7 C.F.R. §1951.911(a)(4)(i) (1992) was not a criterion for eligibility for Leaseback/Buyback Loan Servicing prior to November 28, 1990. Petitioners made their application for Leaseback/Buyback Loan Servicing through the FmHA on April 14, 1989, some eight and one-half months before the good faith requirement came into effect. (See Appendix at page A-67.) Indeed, the Eighth Circuit Court of Appeals made an express finding concerning this April 14, 1989, application date, in its November 19, 1993, Opinion. *See, Schmidt v. U.S.D.A.*, 9 F.3d 1952 (8th Cir. 1993). Accordingly, under the plain meaning of the language set forth in subparagraph (a)(4)(i) of §1951.99 (preservation loan service programs), good faith, or the lack thereof, was not a proper grounds for denial of Petitioners' April 14, 1989, Leaseback/Buyback Preservation Loan Servicing Application.[5]

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[5] As set forth in the statement of the case above, Petitioners have consistently maintained that they did not act in bad faith with regard to their loan agreement with the FmHA. Notwithstanding this fact, however, good faith was not a requirement for Leaseback/Buyback eligibility at the time that Petitioners applied in April of 1989.

On this particular point, Respondent never argued below that Petitioners had to demonstrate good faith in connection with their April 14, 1989, Leaseback/Buyback application. To the contrary, Respondent's only argument concerning this issue was that Petitioners' Leaseback/-Buyback application was actually made on December 28th of 1990 and, therefore, was subject to the §1951.911 good faith provision. Respondent never contended below that subpart (a)(4)(i)(A) of the Preservation Loan Service Programs Regulation allowed it to deny Petitioners' pre-November 28, 1990, Leaseback/Buyback application.

Rather, it was the Eighth Circuit Court of Appeals, in its November 19, 1993, Opinion, which first raised this particular point. Specifically, the appellate court wrote as follows:

> The Schmidts assert the County Supervisor's earlier bad faith finding on their request for Primary Loan Servicing is not applicable to their request for Leaseback/-Buyback because 7 C.F.R. §1951.911(a)(4)-(i) (1993) makes clear that good faith is required only for Leaseback/Buyback applications made after November 28, 1990. According to the Secretary, the Schmidts' reliance on the regulation is misplaced. The Secretary contends subpart (A) of the regulation bars the Schmidts' request. *See, Id.* §1951.911(a)(4)(i)(A) (earlier bad faith determination made in connection with Primary Servicing binds request for Leaseback/Buyback). With both parties relying on different provisions of the same regulation,

> we cannot say the Secretary's interpretation of the regulation "is without a rational basis." *See, Missouri Dep't of Social Servs. v. United States Dep't of Educ.*, 953 F.2d 372, 375 (8th Cir. 1992).

Schmidt v. U.S.D.A., 9 F.3d 1952 (8th Cir. 1993). (See Appendix at page A-5.)

What the appellate court failed to note in its Opinion is the fact that Respondent premised its argument concerning the previous good faith determination by the FmHA upon Respondent's belief that Petitioners' application for Leaseback/Buyback Loan Servicing was made **after** the November 28, 1990, implementation date *(i.e.*, on December 28, 1990) (see pages 36 through 39 of Respondent/Appellee's Appeal Brief). So the Secretary never opined that subsection (a)(4)(i)(A) could be used to thwart a farmer's application for Leaseback/Buyback Preservation Loan Servicing made prior to November 28, 1990.

And any such interpretation would contravene the stated purpose for creation of the Farmers Home Administration, in the first instance, as well as the intent and purpose of the Agricultural Credit Act of 1987. Pub.L.No. 100-233, 101 Stat. 1586 (1987 Act) *(i.e.*, to ensure that borrowers are able to continue farming operations. 7 U.S.C. §2001[a] [1991]).

Because any case involving a farm family's entitlement to Leaseback/Buyback Preservation Loan Servic-

ing, by necessity, requires a contemporaneous determination of property rights, the due process requirements of the Fifth Amendment to the United States Constitution must be strictly adhered to. (See Appendix at page A-70.) In turn, because constitutional rights are involved, the text of 7 C.F.R. §1951.911(a)(4)(i)(A) must be strictly and narrowly interpreted.

Specifically, the federal regulation at issue plainly states that "[a]ny applicant for Leaseback/Buyback who . . . first applied for Primary Servicing . . . or Leaseback/Buyback on or after November 28, 1990 . . . must have acted in good faith."

It is hard to imagine a clearer statement of the meaning of this particular provision: namely, that the good faith requirement for Leaseback/Buyback Preservation Loan Servicing applies **only** to farmers and farm families who make application for such program "on or after November 28, 1990." This being so, the reference to a prior good faith determination, set forth in subparagraph (a)(4)(i)(A), would be applicable only to Primary Servicing applications which were made "on or after November 28, 1990." In those cases, and those alone, is a prior good faith determination binding on a borrower's subsequent application for Leaseback/Buyback.

That this is the proper interpretation of subparagraph (A) is further demonstrated by the commentary to this section, which reads as follows:

> NOTE: A good faith determination made prior to November 28, 1990, for primary servicing, which was based on the sole fact that the borrower disposed of normal income security before October 14, 1988, without FmHA consent, and it has been determined the proceeds were used for essential household and farm operating expenses of which the borrower would have been entitled to a release of income proceeds in accordance with §1962.17(b)(2)(iii) and exhibit E of subpart A of part 1962 of this chapter, such good faith determination will not be binding for a leaseback/buyback application filed on or after November 28, 1990.

The obvious reason for the rule that a previous good faith determination is not binding for purposes of Preservation Loan Service applications made after November 28, 1990 is that this particular date constitutes the clear line of demarcation between the time when there was no good faith requirement for applicants and the time after which good faith would be essential.

Under Rule 10.1(c) of the Supreme Court Rules, a proper basis for the United States Supreme Court's grant of a Petition for Writ of Certiorari exists "[w]hen a . . . United States Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this court." Such a situation obtains in the case at bar.

If the Eighth Circuit Court of Appeals' interpretation of subparagraph (a)(4)(i)(A) of C.F.R. §1951.911 is allowed to stand, then farmers and their families in this country will be deprived of their entitlement to the various loan servicing protections otherwise afforded under this federal regulation. To avoid such an unfair and unfortunate outcome, the United States Supreme Court should hear and decide this important question of federal law, so that courts in the future can properly apply the entitlement provisions of the FmHA's Preservation Loan Service Programs.

CONCLUSION

For the foregoing reasons, Petitioners, Paul G. Schmidt, Pauline B. Schmidt, Paul A. Schmidt, and the Acro Corporation, respectfully request that their Petition for Writ of Certiorari be granted and that the Supreme Court consider and rule upon the issue raised by this appeal.

Respectfully submitted,

PAUL G. SCHMIDT, PAULINE B. SCHMIDT, PAUL A. SCHMIDT, AND THE ACRO CORPORATION,
Petitioners

By JENNIFFER MORRIS HORAN
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Counsel of Record

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SUPREME COURT OF THE UNITED STATES

No.

A-692

Paul G. Schmidt, Pauline B. Schmidt,
Paul A. Schmidt and
Acro Corporation — *Petitioners*

v.

Mike Espy, Secretary
Department of Agriculture

ORDER

UPON CONSIDERATION of the application of counsel for petitioner,

IT IS ORDERED that the time for filing a petition for a writ of certiorari in the above-entitled case, be and the same is hereby, extended to and including April 27th, 1994.

HARRY A. BLACKMUN
Associate Justice of the
Supreme Court of the
United States

Dated this 22nd day of February, 1994.

UNITED STATES COURT OF APPEALS
For the Eighth Circuit

No. 93-1625WAF

Paul G. Schmidt, et al.,

Appellants,

v.

Mike Espy, etc.,

Appellee.

Appeal from the United States District Court
for the Western District of Arkansas

The petition for rehearing filed by the appellant in this appeal has been considered by the court and is denied.

December 28, 1993

Order Entered at the Direction of the Court:

MICHAEL E. GENS

Clerk, U. S. Court of Appeals, Eighth Circuit

UNITED STATES COURT OF APPEALS
For the Eighth Circuit

No. 93-1625WAF
Paul G. Schmidt, Pauline B.
Schmidt; Paul A. Schmidt;
Acro Corporation,
Appellants,

v.

Mike Espy, Secretary,
U.S. Department of Agriculture
Appellee.

Appeal from the United States District Court
for the Western District of Arkansas

Judgment

This appeal from the United States District Court was submitted on the record of the district court, briefs of the parties and was argued by counsel.

After consideration, it is hereby ordered and adjudged that the judgment of the district court in this cause is affirmed in part and reversed in part in accordance with the opinion of this court.

November 19, 1993

A true copy.
ATTEST
MICHAEL E. GENS
Clerk, U. S. Court of Appeals, Eighth Circuit

UNITED STATES COURT OF APPEALS
For the Eighth Circuit

No. 93-1625WA

Paul G. Schmidt, Pauline B. Schmidt; Paul A. Schmidt; Acro Corporation,

Appellants,

v.

Mike [illegible], Secretary,
U.S. Department of Agriculture,

Appellee.

Appeal from the United States District Court for the Western District of Arkansas

---

Submitted: September 13, 1993
Filed: November 19, 1993

Before JOHN R. GIBSON, FAGG and BEAM, *Circuit Judges.*

FAGG, *Circuit Judge*

Paul G. and Pauline B. Schmidt (the senior Schmidts) and their son, Paul A. Schmidt, farm in Washington County, Arkansas. The senior Schmidts built their dwelling on the farm. Nearly 20 years ago, the family formed Acro Corporation to operate the farm. The senior Schmidts and their son each own half of the corporation, which they treat as a Subchapter S corporation for tax purposes. The senior Schmidts, their son and the corporation (collectively the Schmidts) had Farmers Home

Administration (FmHA) loans secured by livestock, equipment, the senior Schmidts' dwelling and farmland. After the Schmidts breached their loan agreement, the FmHA notified the Schmidts it intended to call their loans.

On April 14, 1989, the Schmidts applied for primary loan servicing, leaseback/buyback, and homestead protection. *See* 7 C.F.R. §1951.906 (1993) (defining FmHA loan servicing programs). The FmHA county supervisor denied the Schmidts' request for primary loan servicing because their improper disposal of cattle pledged as collateral was in bad faith. Several months later, the county supervisor held the Schmidts' bad faith barred their request for leaseback/buyback. The county supervisor also held the senior Schmidts were ineligible for homestead protection because they did not receive any income from their farming operation. The county supervisor's decisions were affirmed throughout the Department Agriculture's administrative appeals process and by the district court. The Schmidts appeal. We affirm in part and reverse in part.

On appeal, the Schmidts do not dispute the county supervisor's holding that they acted in bad faith and thus are ineligible for primary loan servicing. The Schmidts contend, however, that the Secretary failed to follow his own regulation when he denied leaseback/buyback based on their bad faith. The Schmidts assert the county supervisor's earlier bad faith finding on their request for primary loan servicing is not applicable to their request for leaseback/buyback because 7 C.F.R. §1951.911(a)(4)(i) (1993) makes clear that good faith is required only for

leaseback/buyback applications made after November 28, 1990. According to the Secretary, the Schmidts' reliance on the regulation is misplaced. The Secretary contends subpart (A) of the regulation bars the Schmidts' request. *See, id.*, §1951.911(a)(4)(i)(A) (earlier bad faith determination made in connection with primary servicing binds request for leaseback/buyback). With both parties relying on different provisions of the same regulation, we cannot say the Secretary's interpretation of the regulation "is without a rational basis." *See, Missouri Dep't of Social Servs. v. United States Dep't of Educ.*, 953 F.2d 372, 375 (8th Cir. 1992). Indeed, in their briefing for this appeal, the Schmidts do not challenge the Secretary's reading of subpart (A). We thus defer to the Secretary's interpretation of the regulation and affirm the Secretary's denial of the Schmidts' request for leaseback/buyback. *See, Kinion v. United States*, 1993 WL 441739 at *2 (8th Cir. Nov. 3. 1993) (court of appeals may overturn Secretary's decision only if "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law.")

The senior Schmidts also challenge the Secretary's holding that they are ineligible for homestead protection. During at least two of the six years before their application, the senior Schmidts must have received gross farm income reasonably comparable with similar local farms and at least 60 percent of their gross income must have come from farming. *See*, 7 U.S.C. §2000(c)(1)(B),(C) (1988). The senior Schmidts contend their half of Acro Corporation's 1983 and 1984 gross farm income satisfies these requirements. There is no dispute Acro Corporation had gross farm income of over $800,000 in 1983 and

over $1,000,000 in 1984. The Secretary takes the position, however, that a Subchapter S corporation like Acro Corporation must have a distributable net income before the corporation's shareholders derive any income from the farming operation. The Secretary thus concluded the senior Schmidts received no income from the farm operation during 1983 and 1984 because their corporation suffered net losses.

We agree with the Secretary's decision to consider the senior Schmidts' application for homestead protection. Although the senior Schmidts are well into their eighties and their son operated the farm during the years in question, the senior Schmidts are bona fide farmers who have earned their livelihood from family farming and lived on the farm for many years. We also agree with the Secretary's decision to examine the family farming corporation's operations to measure the senior Schmidts' farm income. Like the Secretary, we believe the senior Schmidts should not be barred from homestead protection because their farm is operated by a Subchapter S family farming corporation. In applying the eligibility requirements for homestead protection to the senior Schmidts, however, the Secretary failed to apply the statutory "gross farm income" requirement when he based his eligibility decision on the corporation's failure to turn a profit rather than the corporation's gross revenues from farming. Congress has not limited homestead occupancy to borrowers with profitable farm operations. Because it is unlikely that borrowers who seek homestead protection on foreclosure have enjoyed profitable farming operations, the Secretary's bottom-line analysis would deny

many operators of financially distressed family farming corporations the opportunity to "retain their dwelling through a lease and/or purchase." 7 C.F.R. §1951.911-(b)(1) (1993). We thus conclude the senior Schmidts are entitled to have their eligibility for homestead protection measured by their share of the corporation's gross farm income.

We affirm the Secretary's denial of the Schmidts' request for leaseback/buyback and remand to the district court with instructions to remand to the Secretary for further consideration of Paul G. and Pauline Schmidts' application for homestead protection.

A true copy.

Attest:

Clerk, U. S. Court of Appeals,
Eighth Circuit.

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION

PAUL G. SCHMIDT, PAULINE B. SCHMIDT, PAUL A. SCHMIDT, AND THE ACRO CORPORATION — *Plaintiffs*

v. Civil No. 92-5151

EDWARD J. MADIGAN, SECRETARY OF THE UNITED STATES DEPARTMENT OF AGRICULTURE — *Defendants*

Order

On this 19th day of February, 1993, comes now before the court for consideration the plaintiffs' motion for a new trial or amended order, properly characterized

as a motion for amended order pursuant to Rule 59(e) of the Federal Rules of Civil Procedure, and the court finds that the motion should be and hereby is denied;

FURTHER, the court would state that the parties in this matter were granted, on at least two separate occasions, more than a sufficient time to present to the court any documentation deemed relevant for the disposition of this matter. Furthermore, the court diligently scrutinized the provided documentation when considering the defendants' motion to dismiss and defendants' motion for summary judgment filed in this matter.

FURTHER, plaintiffs are again reminded that a judicial review of administrative proceedings is highly deferential and extremely limited, confined to the evidence placed before the agency and relied upon by the agency in issuing its decision. The court is convinced that the complete administrative record, as it existed at the administrative level, was presented to the court by the parties and the court again carefully considered each document of the administrative record when conducting the review of administrative proceedings. Any argument by plaintiffs that the government attempted or succeeded in a perpetration of a fraud upon the court has been unsubstantiated and is without merit. The plaintiffs' motion to that effect is therefore properly denied.

IT IS SO ORDERED.

H. FRANKLIN WATERS
United States District Judge

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION

PAUL G. SCHMIDT, et al. *Plaintiffs*

v. Civil No. 92-5151

EDWARD J. MADIGAN, SECRETARY
OF THE UNITED STATES
DEPARTMENT OF AGRICULTURE *Defendant*

Order

On this 28th day of January, 1993, upon consideration of the administrative record submitted by the United States Department of Agriculture in the above styled case, the court finds that the final agency decision of the Director for the National Appeals Staff for the Department of Agriculture was not arbitrary, capricious or illegal. The court finds that it is beyond the power of the courts to retry the issues properly before the administrative agency for determination and that the agency could fairly and reasonably find the facts as it found them;

FURTHER, the court finds that the agency correctly applied the relevant laws and federal regulations in reaching its conclusions. After thorough examination of the administrative record, it is evident to the court that plaintiffs were afforded every opportunity to apply for primary loan servicing and preservation programs and were given exhaustive avenues of appeal when denied participation in each of those programs. At each stage, the plaintiffs' file was reviewed completely and each of the applicable federal regulations were considered by the agency.

THEREFORE, the court is persuaded that the decisions of the agency with respect to plaintiffs are support-

ed by substantial evidence contained within the administrative record and should not be disturbed;

ACCORDINGLY, this action is dismissed.

IT IS SO ORDERED.

H. FRANKLIN WATERS
United States District Judge

January 27, 1993

Paul G. Schmidt et al. v. Edward Madigan, Secretary of the U. S. Dpt. of Agriculture
Civil No. 92-5151

District Court's Opinion

The court has requested and how has received from the United States Department of Agriculture the complete administrative record in the above styled matter. The record is certified by Lonnie D. Ewing, the County Supervisor for the Farmers Home Administration and custodian of all county office records pertaining to action taken in response to plaintiffs' requests for primary and preservation loan servicing. Mr. Ewing also certifies that he is the custodian of all records, correspondence and documentation in reference to the plaintiffs' administrative appeals. Mr. Ewing certifies that the submitted record is the complete administrative record upon which the FmHA's decisions were made. There has been no submission of documentation by the plaintiffs; neither has there been objection by plaintiffs to the submitted record.

a. Standard of Review

As stated in an earlier opinion letter of the court, a limited judicial review of the administrative record is appropriate at this time. The court has carefully consid-

ered the administrative record, recognizing the restraints placed upon its review by the United States Supreme Court and the Court of Appeals for the Eighth Circuit, and for the reasons stated below, the court finds that the actions taken by the Farmers Home Administration were neither arbitrary, capricious or illegal. The court further finds that the decisions of the Farmers Home Administration should not be disturbed.

As both the court and the parties are now familiar with the facts, the court will dispense with another lengthy synopsis of the case and proceed directly with a review of the submitted administrative record. Stated in prior correspondence with both parties, the standard of review in administrative cases such as this is highly circumscribed. The Administrative Procedures Act provides for only a limited judicial review of a final administrative decisions. *See* 5 U.S.C. §701 *et seq.* The plaintiffs have alleged that agency decisions were "arbitrary and capricious" and thus a violation of the plaintiffs' constitutional rights. The standard of review for agency decisions alleged to be arbitrary and capricious is a narrow and highly deferential standard, *Walsh v. U. S. Army Corp. of Engineers*, 757 F.Supp. 781, 784 (W.D. Tex. 1990), entitling the final agency decision a presumption of validity. *Louisiana Envtl. Soc'y, Inc. v. Dole*, 707 F.2d 116, 118-19 (5th Cir.), *reh'g denied*, 711 F.2d 1054 (1983). The "arbitrary and capricious" standard does not permit the court to substitute its judgment for that of the agency. *City of Houston v. FAA*, 679 F.2d 1184, 1190 (5th Cir. 1982); *Walsh v. Army Corp. of Engineers, supra.*

Where thee is an agency record, the review pro-

ceeding is essentially an appeallate proceeding and the review is limited to the record made before the agency. *Rybacher v. EPA*, 904 F.2d 1276, 1296 (9th Cir. 1990). Furthermore, under subsection 706(2)(A), a court is confined to consider the existing administrative record, *Arkla Exploration Co. v. Texas Oil & Gas Corp.*, 734 F.2d 347, 357 (8th Cir. 1984), *cert. denied*, 469 U.S. 1158 (1985); *Association of Significantly Impacted Neighbors v. City of Livonia*, 765 F.Supp. 389 (E.D. Mich. 1991), determining whether the decision was based on a consideration of the relevant factors or whether there has been a clear error of judgment. *Avoyelles Sportsmen's League, Inc. v. Marsh*, 715 F.2d 897, 904 (5th Cir. 1983).

The focal point for this determination must be the agency record and not a record manufactured by the reviewing court. *See Florida Power & Light Co. v. Lorion*, 470 U.S. 729, 743 (1985). As a result, evidence not present before the agency, evidence wrongfully excluded by the agency and newly discovered evidence may not be received by the reviewing court. *See* Bernard Schwartz, *Administrative Law*, §10.2, (3rd ed. 1991). In other words, "the agency's action must be *reviewed on the basis articulated by the agency and on the evidence and proceedings before the agency at the time it acted.*" *American Mining Congress v. Thomas*, 772 F.2d 617 (10th Cir. 1985), *cert. denied*, 476 U.S. 1158 (1986) (emphasis added). If the court feels that additional evidence should be heard, it should remand the case to the agency. *Id.*

Not only is the review restricted to the administrative record, but also it is limited to the issues raised before the agency. Both orderly procedure and good admin-

istration require that objections to agency proceedings be made while the agency has an opportunity for correction. Thus, an issue not raised at the administrative level may not be considered on review.[1] *Farrokhi v. INS*, 900 F.2d 697 (4th Cir. 1990). Furthermore, review is restricted not only to the issues before the agency but also is limited to the basis upon which the agency purports to deal with those issues. *SEC v. Chenery Corp.*, 318 U.S. 80 (1943).

The proper standard for review for administrative decisions depends upon whether the question presented concerns a question of law or fact. Questions of law are to be determined de novo, on the independent judgment of the reviewing court. *Facet Enterprises v. NLRB*, 907 F.2d 963, 970 (10th Cir. 1990). Questions of fact, however, are reviewed differently. Where a challenged finding is one of fact, the court may not substitute its judgment for that of the agency if it ascertains that the finding is supported by "substantial evidence." *Mississippi Valley Barge Line Co. v. United States*, 292 U.S. 282, 286-287 (1934); *St. Joseph Stock Yards Co. v. United States*, 298 U.S. 38, 51 (1936); and *ICC v. Union Pac. R. Co.*, 222 U.S. 541, 548 (1912).

The substantial evidence test has been said to be one of reasonableness: "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *Consolidated Edison Co. v. NLRB*, 305 U.S. 197, 229 (1938) (C.J., Hughes). The evidence in support of a

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1. The single exception to this rule is that objections to agency jurisdiction may be considered on review though not present at the agency level. Manual Enterprises v. Day, 370 U.S. 478, 499 (1962).

fact finding is substantial when from it an inference of existence of the fact may be reasonably drawn. *See*, Shaw, *supra*, at §10.7. The reviewing court, however, may not weigh the quality or the quantity of the evidence for sufficiency to determine the reasonableness of the agency's decision. The court simply must determine whether an agency could fairly and reasonably find the facts as it did. If the evidence is overwhelmingly against the agency finding, it should not be upheld. But, if the case is a close one, with strong evidence on both sides, there is room for a reasonable difference of opinion. A finding either way would be reasonable and the agency decision must be upheld even of the reviewing judge would have found the other way. *See*, Shaw, *supra*, at §10.8.

b. Administrative Record

A thorough consideration of the administrative record reveals the following: Plaintiffs entered into a security agreement with the FmHA as evidenced by "Security Agreement (Chattels and Crops)" dated March 28, 1985, which pledged land and equipment as collateral, also including as security 3 bulls, 20 heifers, 62 cows, 19 steers and 19 calves. See Attachment 2. Thereafter, on January 9, 1986, the plaintiffs were notified by the FmHA that between March 28, 1985 and January 4, 1986, proceeds from a sale of twenty-three of the animals constituting security were unaccounted for and plaintiffs were informed that they must either remit the amounts received for those animals to the FmHA or replace the security. See Attachment 3. After receiving the FmHA's Notice of Intent to Take Adverse Action, plaintiffs responded on March 14, 1986, by letter from attorney Larry Froelich,

addressing the three problems pointed out by the FmHA county supervisor, Lonnie Ewing: (1) loan installments behind schedule; (2) unapproved disposition of loan collateral; and (3) failure to cooperate in servicing the account. See Attachment 5. Thereafter, on April 3, 1986, plaintiffs submitted to Mr. Ewing an accounting which indicated that no more than 10 animals were missing from the sale proceeds and that since 2 animals remained on the farm and seven had died, no more than one animal remained unaccounted. See Attachment 4.

The record reflects that no action was taken by the FmHA with respect to plaintiffs until February 27, 1989, at which time a Notice of Foreclosure was mailed to the plaintiffs, stating that plaintiffs were $334,724.86 behind on their loan payments, that plaintiffs did not receive written approval to dispose of certain animals serving as security and that plaintiffs have not provided monthly cash flow statements as agreed. See Attachment 6. On March 10, 1989, plaintiffs responded to the FmHA's Notice of Intent to Accelerate the loans, requesting a meeting with the FmHA county office, an administrative appeal hearing and consideration for primary and preservation loan servicing. See Attachment 7.

On April 3, 1990, the FmHA state director authorized the county supervisor to bid up to $100,000.00 at the foreclosure sale of plaintiffs' property to be held on April 10, 1990 in an effort to protect the FmHA's interest in the property. See Attachment 10. A letter to the state director dated April 10, 1990, indicates that the FmHA purchased the plaintiff's property at the sale for $100,000.00. See attachment 9. The letter also states that Leaseback/-

Buyback protection will have to be considered as well as primary and preservation servicing of the property. See Attachment 9.

A letter to the plaintiffs from the National Appeals Staff on June 8, 1990, indicated that the plaintiffs' request for an appeal of the FmHA's decision to accelerate their loans for failure to properly account for loan security had been granted and that the hearing was conducted on May 15, 1990. See Attachment 10. The hearing officer, Elizabeth Wallace, states that she reviewed the file, the tape of the hearing and all of the relevant FmHA laws and regulations relating to the plaintiff's appeal, and determined that the FmHA's decision to accelerate based upon failure to account for security and failure to provide cash flow statements was correct. The plaintiffs were found to have acted in "bad faith" with respect to the disposal of loan security. Ms. Wallace's letter informs the plaintiffs of their right to continue to appeal the FmHA's adverse decision. See Attachment 10. An accompanying appeal summary iterates all of the factors taken into consideration with respect to the May 15th hearing and subsequent affirmance of the adverse decision.

On July 6, 1990, plaintiffs were mailed notice of the availability of Homestead Protection by the county supervisor. See Attachment 23. By letter on October 2, 1990, from Steven D. Tennant, attorney, the plaintiffs requested consideration for Homestead Protection for the purpose of leasing their homestead with an option to purchase. See Attachment 24. Plaintiffs were then notified on October 9, 1990 of the information required to process their request for Homestead Protection. See At-

tachment 25. Plaintiffs were also notified of the availability of leaseback/buyback protection on July 6, 1990. See Attachment 32. The letter from the county supervisor indicates that application for this protection must be made by January 2, 1991. See Attachment 32.

The plaintiffs requested an additional appeal of the FmHA's adverse decision with respect to acceleration. By letter dated November 16, 1990, the Hearing Appeals Staff notified plaintiffs that they had failed to present conclusive evidence that they had properly accounted for the loan security or provided the required monthly financial statements to the FmHA, and therefore, the decision to accelerate plaintiffs' loans was upheld. The letter indicated that any appeal of this decision would have to be made in writing within thirty days. See Attachment 12.

Thereafter, on November 21, 1990, the county supervisor denied the plaintiffs' request for Homestead Protection, stating (1) that only individuals are eligible for Homestead Protection and not corporate entities, (2) that the farm income was not reasonably commensurate for the size of the farm, (3) that the farm had no income for the past four years and a loss in the remaining two years in question and (4) that a feasible plan has not been developed and thus plaintiffs do not have sufficient income to make rental payments on the farm. See Attachment 26. These determinations were made in part by consideration of plaintiffs' federal income tax returns for 1984, 1985, 1986, 1987, 1988, and 1989. See Attachment 26A.

On November 30, 1990, the Farmer Programs Chief notified the FmHA state directors, district directors

and county supervisors of the 1990 Farm Bill, which brought about substantial changes to the FmHA's loan servicing authorities. As a result of the Farm Bill, borrowers who had been determined to be in "bad faith" prior to November 28, 1990, would still be eligible for loan servicing if certain requirements were fulfilled. See Attachment 14. Thereafter, a letter to plaintiff from the National Appeals Staff, in response to plaintiff's request for an additional appeal, states that although the county office determined that plaintiffs acted in "bad faith" and denied primary loan servicing, the 1990 Farm Bill concludes the plaintiffs' appeal of the matter. The letter states, however, that county office must service the account pursuant to the November 30th letter of the Farmer Programs Chief and determine whether plaintiffs meet the requirements for loan servicing programs despite the "bad faith" determination. See Attachment 13. Plaintiffs thereafter made known their intention to apply for Leaseback/Buyback protection on December 28, 1990. See Attachment 33.

On March 5, 1991, the state director reviewed the plaintiffs' file and concurred with the adverse decision with respect to Homestead Protection. See Attachment 27. Thereafter, on April 1, 1991, an appeal hearing was conducted with respected to this decision. Mr. Kenneth Worsham, a hearing officer with the National Appeals Staff, reviewed the file, the hearing tapes and the relevant laws and regulations and determined that the decision to deny Homestead Protection was correct and should be upheld. See Attachment 28. An appeal summary setting forth the factors considered in affirming the adverse deci-

sion accompanied the decision of the National Appeals Staff. See Attachment 28A. Thereafter, on June 13, 1991, an additional appeal hearing was conducted by the state director to review the county supervisor's denial of Homestead Protection. The decision was upheld by the Mr. Michael Dunaway of the state director's office. See Attachment 29. On July 9, 1991, plaintiffs appealed this decision. See Attachment 30.

Then on August 23, 1991, the county supervisor requested that plaintiffs provide within fifteen days updated information so that the FmHA could service the plaintiffs' request for primary loan servicing and Leaseback/Buyback Protection. See Attachment 15 and Attachment 34. By letter on September 6, 1991, the plaintiffs informed the county supervisor that the initial decision to deny primary servicing to plaintiffs' loans was reversed on August 14, 1991, by M. Alan West, acting director of the National Appeals Staff. Plaintiffs also stated that they were currently under another appeal for denial of Homestead Protection. Plaintiffs indicated that it was their understanding that, pursuant to federal regulations, final appeals must be concluded prior to processing additional servicing options. Consequently, plaintiffs refused to provide the requested information for Leaseback/Buyback Protection. See Attachment 16 and Attachment 35.

The county supervisor responded on September 12, 1991, again requesting that the plaintiffs to submit the information for processing the primary loan servicing request. See Attachment 17 and Attachment 36. Plaintiffs responded on October 14, 1991, stating again that no action should be taken prior to an appeal of the Homestead

protection decision, again refusing to provide requested information. See Attachment 18 and Attachment 37. The county supervisor thereafter mailed a Notice of Intent to Accelerate or Continue Acceleration and Notice of Borrowers' Rights, indicating that plaintiffs were $516,838.52 behind in scheduled loan payments, that plaintiffs disposed of loan security without proper approval, and that plaintiffs failed to provide monthly financial statements and information requested by certified letters dated August 23, 1991 and September 12, 1991. See Attachment 19. Then, on December 3, 1991, the county supervisor denied the plaintiffs' request for Leaseback/Buyback Protection for failure to provide the required information and for the "bad faith" determination made with respect to loan security. See Attachment 38. The plaintiffs requested an appeal hearing on December 18, 1991. See Attachment 20.

On January 14, 1992, the National Appeal Staff again reviewed the county supervisor's decision to deny Homestead Protection to the plaintiffs. Based on a thorough review, Mr. John Gleason, for the office of the Director of the National Appeals Staff, concluded that the decision to deny Homestead protection was correct, stating that the county supervisor applied the appropriate regulations in making his determination. The National Appeals Staff also concluded that the county supervisor's decision was supported by the factual record. See Attachment 31. An appeal summary accompanied the decision of the National Appeals Staff. See Attachment 31.

An appeal hearing was held on February 19, 1992. On March 5, 1992, Mr. Thomas Anthony, Jr. reviewed the

file, the hearing tape, and the relevant laws and determined that the FmHA's denial of debt restructuring and the decision to accelerate the plaintiffs' loans should be upheld. This conclusion was based upon plaintiffs' failure to account for loan security, to provide monthly financial statements and to provide requested information relating to loan servicing programs. The decision specifically upheld the FmHA's decision to deny primary loan servicing because of plaintiffs' failure to act in "good faith." See Attachment 21 and Attachment 39.

Thereafter, on May 6, 1992, the state director reviewed the county supervisor's unfavorable decision with respect to Leaseback/Buyback Protection and loan acceleration, determining that the decision was correct and should be upheld. See Attachment 40. On July 7, 1992, these decisions were again upheld by Frederick R. Young, Director for the National Appeals Staff, after a careful review of the file and the hearing tapes. Mr. Young's letter states that "this is the final administrative appeal of the plaintiffs' case." See Attachment 22 and Attachment 41.

c. Court's Review

The final decision of the agency is entitled to a presumption of validity, allowing this court only to determine whether the decision was based upon a consideration of the relevant factors or whether there has been a clear error of judgment. Confining its review to the existing administrative record and recognizing that the "arbitrary and capricious" standard does not permit the court to substitute its judgment for that of the agency, the court finds that the agency decision was based upon a consider-

ation of the relevant factors as that the record is replete with "such relevant evidence as a reasonable mind might accept as adequate to support" the conclusions of the FmHA with respect to plaintiffs' "good faith." The record also contains substantial evidence on each of the additional determinations made by the FmHA with respect to acceleration of plaintiffs' loans as well as the plaintiffs' eligibility for primary and preservation loan servicing, Homestead Protection, and Leaseback/Buyback Protection.

Accordingly, the court finds that the final agency decision of the Director of the National Appeals Staff for the Department of Agriculture was not arbitrary, capricious or illegal. The court finds that the FmHA could fairly and reasonably find the facts as it found them and it is beyond the power of the courts to retry the issues properly before the administrative agency for determination. The court further finds that the FmHA correctly applied the relevant laws and federal regulations in reaching its conclusions. After thorough examination of the administrative record, it is evident to the court that plaintiffs were afforded every opportunity to apply for primary loan servicing and preservation programs and were given exhaustive avenues of appeal when denied participation in each of those programs. At each stage, the plaintiffs' file was completely reviewed and each of the applicable federal regulations were considered by the agency. The court is persuaded, therefore, that the decisions of the FmHA with respect to the plaintiffs have a reasonable basis in the administrative record and should not be disturbed.

A separate order in accordance herewith will be

entered concurrently.

Yours very truly,
H. Franklin Waters

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION

PAUL G. SCHMIDT, et al. *Plaintiffs*

v. Civil No. 92-5151

EDWARD MADIGAN, SECRETARY
OF THE UNITED STATES
DEPARTMENT OF AGRICULTURE *Defendant*

Order

On this 11th day of January, 1993, upon consideration of defendant's motion for summary judgment, the court finds for the reasons set forth in a letter of even date that said motion should be and hereby is denied.

Further, the parties are ordered to submit to the court any of the administrative record, not presently before the court, by the close of business on January 22, 1993.

It is so ordered.

H. Franklin Waters
United States District Judge

January 8, 1993

Paul G. Schmidt et al. v. Edward Madigan, Secretary of the U. S. Dpt. of Agriculture
Civil No. 92-5151

District Court's Summary Judgment Opinion

Currently before the court is a motion for sum-

mary judgment and brief in support filed on behalf of the defendant, the United States, by Edward Madigan, the Secretary of the United States Department of Agriculture. The plaintiffs, Paul G. Schmidt and others were granted additional time to respond. The court has considered the motion, brief, and response, along with the affidavits and attachments thereto and is now ready to rule. For the reasons set forth below, the court finds that the motion for summary judgment should be and hereby is denied.

The plaintiffs filed an action requesting a review by this court of a final administrative agency decision issued by the Director of the National Appeals Staff of the Department of Agriculture on July 7, 1992. In that decision, the FmHA's denial of the plaintiffs' application for Primary Loan Servicing under the Agricultural Credit Act of 1987 based upon a finding of "bad faith" with respect to certain loan collateral was upheld. The agency's refusal of the plaintiffs' application for Homestead Protection under the Act, finding that the plaintiffs lacked "gross farm income" within the last six years as required by regulations promulgated under the Act was also upheld. The plaintiffs' complaint requests that this court enjoin the federal marshal from carrying out a writ of assistance issued by this court on August 19, 1992, and declare the actions taken by the FmHA arbitrary, capricious and, as such, constitutional deprivations of the plaintiffs' rights and property.

By letter opinion and order the court previously denied a motion to dismiss filed by defendant United States. By order entered on November 10, 1992, this court

found that plaintiffs were entitled, by federal statute and regulation, to a judicial review of the final agency determinations. It is well established that a plaintiff must normally exhaust his administrative remedies before proceeding in federal court. *See Bowen v. City of New York*, 476 U.S. 467, 484 (1985). It is likewise undisputed that the plaintiffs in this case exhausted their administrative remedies through the Department of Agriculture and, as a result, obtained a final administrative decision on July 7, 1992, in accordance with 7 C.F.R. §1900.59(b):

> (b) *Finality* A decision made when an appeal is concluded will be administratively final.

The letter of the Director of the National Appeals Staff of July 7, 1992, denying the plaintiffs' applications for loan servicing, clearly states on page two that "[t]his review concludes the administrative appeal of your case." Thus, plaintiffs exhausted their administrative remedies and received a final agency determination with respect to loan servicing on July 7, 1992. Since the Administrative Procedures Act (APA), 5 U.S.C. §704, provides for judicial review of "final agency action for which there is no other adequate remedy," and because the prior adjudication of foreclosure and subsequent writ of assistance issued by this court leave the plaintiffs with no available remedy, this court found that, pursuant to the APA, plaintiffs are entitled to a review of the final administrative decision of the Department of Agriculture. *See* Letter Opinion of the Court, November 10, 1992.

By its letter opinion, the court requested that par-

ties submit the administrative record so that a review of agency actions could proceed. The parties have responded instead with a motion for summary judgment and the accompanying briefs, responses, affidavits and documents. After careful consideration of the matter, the court believes it improper to decide this case on a summary judgment motion for the following reasons.

The standard of review in administrative cases such as this is circumscribed. The Administrative Procedures Act provides for only a limited judicial review of a final administrative decisions. *See* 5 U.S.C. §701 *et seq.* The plaintiffs have alleged that agency decisions were "arbitrary and capricious" and thus a violation of the plaintiffs' constitutional rights. The standard of review for agency decisions alleged to be arbitrary and capricious is a narrow and highly deferential standard, *Walsh v. U. S. Army Corp. of Engineers*, 757 F.Supp. 781, 784 (W.D. Tex. 1990), entitling the final agency decision a presumption of validity. *Louisiana Envtl. Soc'y, Inc. v. Dole*, 707 F.2d 116, 118-19 (5th Cir.), *reh'g denied*, 711 F.2d 1054 (1983). The "arbitrary and capricious" standard does not permit the court to substitute its judgment for that of the agency. *City of Houston v. FAA*, 679 F.2d 1184, 1190 (5th Cir. 1982); *Walsh v. Army Corp. of Engineers, supra.*

Where there is an agency record, the review proceeding is essentially an appellate proceeding and the review is limited to the record made before the agency. *Rybacher v. EPA*, 904 F.2d 1276, 1296 (9th Cir. 1990). Furthermore, under subsection 706(2)(A), a court is confined to consider the existing administrative record, *Arkla Exploration Co. v. Texas Oil & Gas Corp.*, 734 F.2d 347,

357 (8th Cir. 1984), *cert denied*, 469 U.S. 1158 (1985); *Association of Significantly Impacted Neighbors v. City of Livonia*, 765 F.Supp. 389 (E.D. Mich. 1991), determining whether the decision was based on a consideration of the relevant factors or whether there has been a clear error of judgment. *Avoyelles Sportsmen's League, Inc. v. Marsh*, 715 F.2d 897, 904 (5th Cir. 1983).

The focal point for this determination must be the agency record and not a record manufactured by the reviewing court. *See Florida Power & Light Co. v. Lorion*, 470 U.S. 729, 743 (1985). As a result, evidence not present before the agency, evidence wrongfully excluded by the agency and newly discovered evidence may not be received by the reviewing court. *See* Bernard Schwartz, *Administrative Law*, §10.2, (3rd ed. 1991). In other words, "the agency's action must be *reviewed on the basis articulated by the agency and on the evidence and proceedings before the agency at the time it acted.*" *American Mining Congress v. Thomas*, 772 F.2d 617 (10th Cir. 1985), *cert. denied*, 476 U.S. 1158 (1986) (emphasis added). If the court feels that additional evidence should be heard, it should remand the case to the agency. *Id.*

Not only is the review restricted to the administrative record, but also it is limited to the issues raised before the agency. Both orderly procedure and good administration require that objections to agency proceedings be made while the agency has an opportunity for correction. Thus, an issue not raised at the administrative level may

not be considered on review.[1] *Farrokhi v. INS*, 900 F.2d 697 (4th Cir. 1990). Furthermore, review is restricted not only to the issues before the agency but also is limited to the basis upon which the agency purports to deal with those issues. *SEC v. Chenery Corp.*, 318 U.S. 80 (1943).

The proper standard for review for administrative decisions depends upon whether the question presented concerns a question of law or fact. Questions of law are to be determined de novo, on the independent judgment of the reviewing court. *Facet Enterprises v. NLRB*, 907 F.2d 963, 970 (10th Cir. 1990). Questions of fact, however, are reviewed differently. Where a challenged finding is one of fact, the court may not substitute its judgment for that of the agency if it ascertains that the finding is supported by "substantial evidence." *Mississippi Valley Barge Line Co. v. United States*, 292 U.S. 282, 286-287 (1934); *St. Joseph Stock Yards Co. v. United States*, 298 U.S. 38, 51 (1936); and *ICC v. Union Pac. R. Co.*, 222 U.S. 541, 548 (1912).

The substantial evidence test has been said to be one of reasonableness: "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *Consolidated Edison Co. v. NLRB*, 305 U.S. 197, 229 (1938) (C.J., Hughes). The evidence in support of a fact finding is substantial when from it an inference of existence of the fact may be reasonably drawn. *See*, Shaw, *supra*, at §10.7. The reviewing court, however, may not

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1. The single exception to this rule is that objections to agency jurisdiction may be considered on review though not present at the agency level. Manual Enterprises v. Day, 370 U.S. 478, 499 (1962).

weigh the quality or the quantity of the evidence for sufficiency to determine the reasonableness of the agency's decision. The court simply must determine whether an agency could fairly and reasonably find the facts as it did.

If the evidence is overwhelmingly against the agency finding, it should not be upheld. But, if the case is a close one, with strong evidence on both sides, there is room for a reasonable difference of opinion. A finding either way would be reasonable and the agency decision must be upheld even of the reviewing judge would have found the other way. *See*, Shaw, *supra*, at §10.8.

Thus, the court is obligated to review the final agency determination in accordance with the above stated parameters, and determine whether the decisions of the Director for the National Appeals Staff for the Department of Agriculture were "arbitrary and capricious." To conduct a proper review, therefore, the court must have before it the complete administrative record. While the court believes that the record is presently before the court, the court will grant to the parties an additional **fifteen (15) days from the date above** to submit any further documentation of relevant agency proceedings. The court is convinced that, due to the narrow role which the reviewing court plays in administrative cases, further pleadings from counsel is unnecessary at this time.

A separate order in accordance herewith will be entered concurrently.

Yours very truly,

H. FRANKLIN WATERS

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION

PAUL G. SCHMIDT, PAULINE
SCHMIDT, PAUL A. SCHMIDT
AND THE ACRO CORPORATION — *Plaintiffs*

v. Civil No. 92-5151

EDWARD J. MADIGAN, SECRETARY
OF THE UNITED STATES
DEPARTMENT OF AGRICULTURE — *Defendant*

Order

Now, on this 10th day of November, 1992, upon consideration of the defendant's motion for dismissal, the court finds that said motion should be and hereby is denied.

FURTHER, the parties are ordered to submit to the court within **30 (thirty) days** the complete administrative agency record in this matter so that the court may conduct a limited review of the agency's final decision to see if it was "arbitrary or capricious" within the meaning of the Administrative Procedures Act, 5 U.S.C. §701 *et seq.*

IT IS SO ORDERED.

H. FRANKLIN WATERS
United States District Judge

November 10, 1992

Paul G. Schmidt et al. v. Edward Madigan, Secretary of the U. S. Dpt. of Agriculture
Civil No. 92-5151

District Court's Motion Ruling

Currently before the court is a motion to dismiss

and brief in support filed on behalf of the defendant, the United States, and a response to said motion filed by the plaintiffs, Paul G. Schmidt and others. The court has considered the motion and the various briefs and responses thereto and is now ready to rule. For the reasons set forth below, the court finds that the motion to dismiss should and hereby is denied.

The plaintiffs filed an action requesting a review by this court of a final administrative agency decision issued by the Director of the National Appeals Staff of the Department of Agriculture on July 7, 1992. In that decision, the FmHA's denial of the plaintiffs' application for Primary Loan Servicing under the Agricultural Credit Act of 1987 based upon a finding of "bad faith" with respect to certain loan collateral was upheld. The agency's refusal of the plaintiffs' application for Homestead Protection under the Act, finding that the plaintiffs lacked "gross farm income" within the last six years as required by regulations promulgated under the Act, was also upheld. The plaintiffs additionally request that this court enjoin the federal marshal from carrying out a writ of assistance issued by this court on August 19, 1992, and declare the actions taken by the FmHA arbitrary, capricious and, as such, constitutional deprivations of the plaintiffs' rights and property.

Without a tedious recitation of the entire factual posture of this case, which spans many years and involves prior litigation, the court will proceed to address the defendant's motion to dismiss as it relates to the plaintiffs' request for judicial review of an administrative decision, including only the facts necessary to resolve the issue. The

court notes that the plaintiffs' request for preliminary and permanent injunctive relief previously has been referred to Magistrate Judge Beverly R. Stites for a determination of that matter.

The plaintiffs conducted agricultural operations in Washington County, Arkansas from the early 1960s until the late 1980s. During the 1980s, however, the plaintiffs encountered many agricultural and financial difficulties, and in 1986, the plaintiffs were forced to file Chapter 11 bankruptcy. Thereafter, in 1988, the plaintiffs voluntarily withdrew their bankruptcy petition and, in 1989, the FmHA accelerated the plaintiffs' loans. The acceleration notice given by the FmHA informed the plaintiffs that they could apply for Primary and Preservation Loan Servicing programs provided by the government. On April 14, 1989, the plaintiffs submitted their applications for these loan servicing programs.

Subsequently, on May 5, 1989, the FmHA allegedly advised the plaintiffs that their application for Primary Loan Servicing would be denied because the plaintiffs had acted in "bad faith" by not accounting for 23 cows, 1 bull, and 1 yearling, collateral for the plaintiffs' loans, and by failing to provide the FmHA with required cash flow statements of plaintiffs' operations. The plaintiffs then appealed this decision up to the Director of the National Appeals Division, who reversed the "bad faith" determination on August 14, 1991, and instructed the FmHA to service the plaintiffs' loan in accordance with federal regulations.

In the mean time, however, while the plaintiffs awaited the decision of the National Appeals Division,

the FmHA outbid the plaintiffs at a judicial sale of the property which was subject to be serviced by the loan program. After the FmHA acquired title to the property, the plaintiffs then applied for homestead protection and leaseback/buyback protection pursuant to federal regulations.

The FmHA subsequently denied the plaintiffs homestead protection, finding that the plaintiffs did not have any gross farm income during the past six years. And, despite the earlier decision of the National Appeals Division, the FmHA continued to deny the plaintiffs Primary Loan Servicing, also denying leaseback/buyback protection, on the grounds of "bad faith." The plaintiffs again appealed these decisions all the way up to a new National Director of the Appeals Division. On this appeal, the Director upheld the FmHA determination of "bad faith" in a final administrative decision, and, as a result, the plaintiffs' applications for loan servicing, homestead protection and leaseback/buyback protection were denied. The plaintiffs then filed this action for review of the final administrative decision along with requests for declaratory and injunctive relief.

The defendant has filed a Rule 12(b) motion to dismiss, contending that the plaintiffs have failed to state a claim for which relief can be granted by this court. First, the defendant alleges that the claims asserted by the plaintiffs are barred by the doctrines of *res judicata* and collateral estoppel since a judgment and decree of foreclosure on the property was previously entered against the plaintiffs on February 21, 1990. Second, the defendant argues that the appropriate standard of review for admin-

istrative actions has not been met by the plaintiffs, alleging failure on part of the plaintiffs to establish that the agency actions were "arbitrary, capricious or illegal" as required by the Administrative Procedures Act. 5 U.S.C. §701, et seq. The defendant additionally argues that the plaintiffs have not illustrated probable success on the merits and possible irreparable injury which are required before issuance of a preliminary injunction.

A Rule 12(b) motion is to be read as a whole, *Continental Ore Co. v. Union Carbide and Carbon Corp.*, 370 U.S. 690 (1962), and it is to be denied unless "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957); *Bennett v. Berg*, 710 F.2d 1361 (8th Cir. 1983). In addition, complaints are to be "liberally construed in favor of the plaintiff." *See Jenkins v. McKeithen*, 395 U.S. 411, 421 (1969), and *United States v. Advance Machine Corp.*, 547 F.Supp. 1085, 1088 (D. Minn. 1982). It has also been said that all facts pleaded in the complaint are taken to be true for 12(b)(6) purposes, *Hospital Building Co. v. Trustees of Rex Hospital*, 425 U.S. 738, 740 (1976), and all reasonable inferences from facts pleaded in the complaint are to be drawn and deemed to be true. *See* Wright & Miller, *Federal Practice and Procedure* §1363 (1969).

Addressing the defendant's first argument, that plaintiffs' claims are barred by res judicata and collateral estoppel, the court fails to understand how a final administrative order, issued on July 7, 1992, possibly could have been litigated, or even contemplated, in a legal action between the Farm Credit Bank of St. Louis, the plaintiffs

and the FmHA occurring two years prior in 1990. While the defendant has correctly cited Arkansas law which recognizes and thoroughly addresses the doctrines of claim preclusion and issue preclusion, commonly referred to as res judicata and collateral estoppel, the application of those doctrines is misplaced in this case.

The defendant contends that the decision of this court on February 20, 1990, precludes the plaintiffs' claim for judicial review of the administrative decision. However, the defense of res judicata can not be raised unless and until proceedings have resulted in a final judgment. *See Stokes v. Twin City Motors, Inc.*, 490 F.Supp. 742, 745 (8th Cir. 1980). Clearly, the earlier judgment of this court did not and could not encompass any final ruling or judgment with respect to the final decision of the Department of Agriculture. This is because the final agency decision was not issued until two years after the court's decision. The defendant is correct in stating that the plaintiffs are barred from further litigating issues which could have been raised and litigated in the earlier action. However, at the time of that decision, the plaintiffs had not yet exhausted their administrative remedies through the FmHA with respect to loan servicing, homestead protection and leaseback/buyback protection. Thus, these issues were not addressed, nor could they have been addressed, in the court's 1990 opinion.

It is well established that a plaintiff must normally exhaust his administrative remedies before proceeding in federal court. Recognizing this general rule, the Supreme Court, in *Bowen v. City of New York*, 476 U.S. 467, 484 (1985), stated that the "application of the exhaustion doc-

trine is 'intensely practical.' " *Id.* The Court quoted from *Weinberger v. Salfi*, 422 U.S. 749 (1975):

> Exhaustion is generally required as a matter of preventing premature interference with agency processes, so that the agency may function efficiently and so that it may have an opportunity to correct its own errors, to afford the parties and the courts the benefit of its experience and expertise, and to compile a record which is adequate for judicial review.

Salfi, 422 U.S. at 765. It is undisputed that the plaintiffs in this case exhausted their administrative remedies through the Department of Agriculture and, as a result, did not have a final administrative decision until July 7, 1992, in accordance with 7 C.F.R. §1900.59(b):

> (b) *Finality* A decision made when an appeal is concluded will be administratively final.

The letter of the Director of the National Appeals Staff of July 7, 1992, denying the plaintiffs' applications for loan servicing, clearly states on page two that "[t]his review concludes the administrative appeal of your case." Thus, the plaintiffs exhausted their administrative remedies and received a final agency determination with respect to loan servicing on July 7, 1992. It was not until then that the plaintiffs could seek judicial review of the agency's actions.

Since the Administrative Procedures Act (APA),

at 5 U.S.C. §704, provides for judicial review of "final agency action for which there is no other adequate remedy," and because the prior adjudication of foreclosure and subsequent writ of assistance issued by this court leave the plaintiffs with no other available remedy, the court finds that, pursuant to the APA, the plaintiffs are entitled to a review of the final administrative decision of the Department of Agriculture.

Turning to the defendant's second argument, that the plaintiffs have failed to meet the standard of review under the APA for review of an agency decision, the court finds that the determination of whether the plaintiffs have met their burden is for the court decide after a judicial review of the administrative record.

The Administrative Procedures Act provides for limited judicial review of a final administrative decision. *See* 5 U.S.C. §701 *et seq.* The plaintiffs have alleged that agency decisions were "arbitrary and capricious" and thus a violation of the plaintiffs' constitutional rights. The standard of review for agency decisions alleged to be arbitrary and capricious is a narrow and highly deferential standard, *Walsh v. U. S. Army Corp. of Engineers*, 757 F.Supp. 781, 784 (W.D. Tex. 1990), entitling the final agency decision a presumption of validity. *Louisiana Envtl. Soc'y, Inc. v. Doie*, 707 F.2d 116, 118-19 (5th Cir. 1983).Under subsection 706(2)(A), a court must consider the existing administrative record, *Association of Significantly Impacted Neighbors v. City of Livonia*, 765 F.Supp. 389 (E.D. Mich. 1991), determining whether the decision was based on a consideration of the relevant factors or whether there has been a clear error of judgment.

Avoyelles Sportsmen's League, Inc. v. Marsh, 715 F.2d 897, 904 (5th Cir. 1983). While the "arbitrary and capricious" standard does not allow the court to substitute its judgment for that of the agency, *City of Houston v. FAA*, 679 F.2d 1184, 1190 (5th Cir. 1982), the court must determine if the agency failed to meet statutory, procedural or constitutional requirements, or if its action is not supported by substantial evidence. *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. Ruckleshaus*, 719 F.2d 1159 (D.D.C. 1983). This is the essence of the plaintiffs' request for review, that is the FmHA failed to follow the prescribed regulatory procedures with respect to loan servicing and the plaintiffs' other program applications.

Thus, the court is obligated to review the final agency determination in accordance with the above stated parameters, and determine whether the decision of the Director for the National Appeals Staff for the Department of Agriculture was "arbitrary and capricious." At that time, the court will consider the numerous federal regulations cited by the parties which bind the agency as well as the participants of the programs for which the plaintiffs applied. And while the court believes that the agency record is presently before the court, the court requests that the parties submit to the court the complete administrative record with respect to this matter so that the court may properly proceed with its review.

The defendant's third contention, that the plaintiffs have failed to meet the requisite standard for issuance of a preliminary injunction will not be addressed by the court at this time since, as stated above, the injunctive issue has been referred to Magistrate Judge Beverly R.

Stites for her consideration of the matter.

Therefore, after liberally construing the defendant's motion to dismiss in favor of the plaintiff and deeming all reasonable inferences from facts pleaded in the complaint to be true, the court believes that the defendant's Rule 12(b) motion to dismiss must be denied. The plaintiffs' request for judicial review of a final administrative decision issued on July 7, 1992, is not barred by res judicata or collateral estoppel as the result of litigation occurring in 1990. The plaintiffs, therefore, are entitled to a limited review of that decision, under the "arbitrary and capricious" standard of review, and the court must conduct this review from the existing administrative record to determine if the plaintiffs' rights have been violated. Thus, the court hereby denies the motion to dismiss and further requests that the parties provide the court **within 30 (thirty) days,** the complete administrative record with respect to the denial of the plaintiffs' loan servicing applications.

A separate order in accordance herewith will be entered concurrently.

Yours very truly,

H. FRANKLIN WATERS

United States Department of Agriculture
Farmers Home Administration
National Appeals Staff
July 7, 1992

ACRO Corporation
c/o Mr. Paul G. Schmidt
18234 Buckhorn Road
Prairie Grove, Arkansas 72701

Re: Appeal Log #92000750S

Dear Mr. Schmidt:

This letter is in response to your correspondence requesting a review of the determination made by the Farmers Home Administration (FmHA) Fayetteville, Arkansas County Supervisor that ACRO Corporation and the members of this entity are ineligible for the leaseback/buyback portion of preservation loan servicing on that parcel of real estate that is currently FmHA inventory property.

We have carefully examined the information contained in your FmHA case file, listened to the audio tape of the appeal hearing held on February 19, 1992, considered your arguments on appeal and reviewed the applicable FmHA Instructions. Based on this information, we have determined that the decision by the County Supervisor to deny leaseback/buyback because of lack of good faith should be upheld.

FmHA Instructions 1951-S, Section 1951.909(c)(2) requires the County Supervisor, in considering the eligibility of borrowers who have applied for Primary Loan Service Programs, to determine that they have acted in good faith by demonstrating sincerity and honesty in

meeting agreements set forth on Form FmHA 1962-1, "Agreement for the Use of Proceeds/Release of Chattel Security," and other agreements with FmHA. Any allegations of fraud, waste and conversion used in order to deny borrowers' requests for Primary Loan Service Programs will be substantiated by FmHA, with a written legal opinion from the Office of General Counsel (OGC), before denying the borrower's request for such programs.

FmHA denied your request for leaseback/buyback servicing because the County Supervisor determined that you have not met the good faith requirements because you failed to properly account for FmHA security.

The County Supervisor received a written legal opinion from OGC on March 3, 1989, substantiating the determination that you have not acted in good faith because of conversion and/or waste of FmHA security. OGC based their opinion on the following facts. FmHA held a valid lien on your cattle herd. An inventory on March 28, 1985, established that there were 123 animals in the herd. The entire herd was sold on January 4, 1986, and based on the sales invoice from Washington County Sales Company, 23 cows, 1 bull and 1 yearling could not be accounted for. Subsequently, it was ascertained that a number of cattle, the exact figure is unknown, may have died, run off or were stolen. According to your attorney, you, "did not have the time or help to properly monitor the cattle." This would constitute waste of FmHA security.

It is your contention that employees of the sales company mislabeled cows as calves and understated the weight of the animals, hence causing the inventory short-

age. You have not introduced any evidence to support this contention.

In summary, the decision of the local County Supervisor to deny a preservation loan service because of your failure to act in good faith is based on FmHA instructions and supported by the facts in the case file. Therefore, we must uphold that decision.

Because we are upholding the lack of good faith determination, the failure to furnish monthly financial statements and the failure to provide updated financial information are moot issues.

Your FmHA case file will be returned to the County Office in Fayetteville, Arkansas, for further servicing. We regret a favorable decision could not have been rendered. This review concludes the administrative appeal of your case.

Sincerely,

FREDERICK R. YOUNG

Director, National Appeals Staff

United States Department of Agriculture
Farmers Home Administration
May 6, 1992

ACRO Corporation
Mr. Paul A. Schmidt
18234 Buckhorn Road
Prairie Grove, Arkansas 72753

Log # 92000795 AR FP
and
Log # 92000750 AR FP

Dear Mr. Schmidt:

This is to correct our letter of May 1, 1992.

You requested a review of an unfavorable decision by the Farmers Home Administration (FmHA) County Supervisor regarding the denial of preservation loan servicing (leaseback/buyback) and intent to accelerate or to continue acceleration of you loans.

We have reviewed your request, your case file, and all relevant FmHA regulations relating to your appeal. Based upon this review, it has been determined that the initial decision was correct and is therefore, upheld.

If you believe that this decision is incorrect and you wish for further action to be taken, you may request a further review of this decision by the National Director of Appeals. In accordance with FmHA regulations, the decision made by the National Director of Appeals will be final and will conclude your administrative appeal.

You must notify the Area Supervisor of Appeals in writing within thirty (30) calendar days of the date of this decision letter if you wish to request a review. Without such notifications, your appeal will be deemed concluded.

Sincerely,
ROBERT L. HANKINS
State Director

United States Department of Agriculture
Farmers Home Administration
National Appeals Staff
March 5, 1992
Appeal Log # 92000750 AR FP

ACRO Corporation
Mr. Paul A. Schmidt
18234 Buckhorn Road
Prairie Grove, Arkansas 72753
Dear Mr. Schmidt:

You requested an appeal of the decision by the Farmers Home Administration (FmHA) to deny ACRO Corporation's request for leaseback. A hearing was held on your request on February 19, 1992, at the Federal Building located in Fayetteville, Arkansas. Attending the hearing were: Thomas W. Anthony, Jr., Hearing Officer of the FmHA's National Appeals Staff; Paul A. Schmidt, President; Pauline E. Schmidt, Secretary-Treasurer; Paul G. Schmidt, Vice-President and General Manager; and Lonnie D. Ewing, FmHA County Supervisor. The hearing was recorded by the Hearing Officer.

I have reviewed your appeal request date stamped January 8, 1992, your case file, the hearing tape, and all relevant FmHA instructions relating to your appeal. Based upon this review, I have determined that FmHA's denial of your application for leaseback should be upheld.

FmHA denied your request for leaseback because

(Item # 1). You have not provided the information necessary to determine whether or not you could fulfill the terms or conditions of a lease (letter originally advising you of Homestead protection and Leaseback/Buyback letters dated 08-23-91 and 09-12-91 requested information), procedural references 1951.911(a)(5)(i) and 1951.911(6). (Item # 2). A determination of not acting in good faith has been made regarding the issue of Basic Security not being properly accounted for. FmHA Instructions 1951.911(a)(4)(i)(A) states if a Good Faith determination has already been made in connection with the borrower's/former borrower's request for primary servicing, such determination will be binding on the request for Leaseback/Buyback.

Item # 1. FmHA Instructions 1910-A, Par. 1910.6 that deals with applications, states that the loan approval official will ask an applicant for updated information if more than 90 days has passed since Form FmHA 1940-1, Application for FmHA Services, was signed. If there have been any significant changes, which would affect eligibility, the County Supervisor will obtain the necessary current information to determine eligibility, or when appropriate, present the application to the County Committee for reconsideration. FmHA Instructions 1951-S, Par. 1951.911 provides that the applicant must furnish the necessary financial information to assist the County Supervisor in determining if a feasible plan of operation can be developed. This instruction also requires that if the owner has requested leaseback, the County Supervisor will determine the owner can fulfill the terms and conditions of the lease. If the County Supervisor determines

that the owner cannot fulfill the terms and conditions of the lease and/or the owner fails to submit the information requested within 15 days of the date which appears on Exhibit K, the application will be disapproved and appeal rights given.

FmHA requested updated information on your application for debt restructuring/leaseback dated in 1989 in their letter to you on August 23, 1991. The letter granted you 15 days to provide the requested material, or if not received, your request for primary services/leaseback would not be processed. On September 12, 1991, FmHA wrote you another letter stating that if you want FmHA to process your request for leaseback, you must have the information contained in our letter dated August 23, 1991, completed and in our office by the close of business on October 15, 1991. The County Supervisor contacted your attorney between September 23, 1991 and October 4, 1991, and advised him that FmHA can request the information cited in the letter, and that if not provided, his clients would be out of luck as it relates to their application for primary and preservation loan services. By notifying your attorney, they in essence notified you of your responsibility to provide the cited information.

You responded to the two FmHA letters on September 6, 1991, and October 14, 1991, advising the county supervisor that "until the homestead protection application appeal is completed further processing of our application can not be undertaken." In summary, FmHA provided you adequate time to update the requested information and you failed to provide the information needed to process your application. This is a basis for denying an

application. Therefore, we must uphold FmHA decision to deny your application for leaseback based upon your failure to provide needed information to process your application for leaseback.

Item #2. FmHA Instructions 1951-S, Par. 1951.911 states that the County Supervisor will determine the applicant's eligibility. Any applicant for leaseback/buyback who first applied for leaseback/buyback must have acted in good faith by demonstrating sincerity and honesty in making agreements set forth on Form FmHA 1962-1 and other agreements with FmHA. Disposal of normal income security prior to October 14, 1988, without FmHA's consent, will not constitute a lack of good faith if the proceeds were used to pay essential household and farm operating expenses and the borrower would have been entitled to a release of income proceeds in accordance with applicable instructions. Any allegation of fraud, waste, and conversion used in order to deny borrowers' requests for Primary Loan Services/Preservation Loan Services will be substantiated by FmHA, with a written opinion from the Office of General Counsel, before denying the borrower's request for such programs.

Our review of the borrower case file shows that there is substantial evidence to support that all cattle were not accounted for when the herd was liquidated. Also, the case file supports that there were substantial, unnecessary losses due to calving, running off, and/or theft which would fall under the definition of waste. Further, cattle were sold earlier and not accounted for until prosecutorial action was taken against you. In addition, you failed to provide monthly cash flow statements as

provided in a written statement to FmHA agreeing to provide these documents. The County Supervisor's position was supported by a legal opinion from the Office of General Counsel as required by instructions. The administrator's unnumbered letter that you mentioned in your defense would not be applicable because the security in question was basic security rather than income security. Therefore, we must uphold FmHA's denial of your application for leaseback because you have not acted in good faith.

If you feel the above decision is incorrect and you wish for further action to be taken, you have at this point in the appeals process two options available for your consideration:

OPTION #1. This option is designed to give you an opportunity to review certain material from the hearing before you decide whether to request a review. You may request a copy of the hearing tape and/or a copy of the balance of the hearing record. These are offered to you at no cost. You may also wish to order the written transcript of the tape, which will be provided to you at the cost of reproduction. The cost of reproduction is currently $3.00 per page or approximately $100.00 per each hearing tape. This is only an estimate; the actual cost could be more or less, depending on the length of the hearing. A transcript will not be ordered unless you specifically state you will pay the cost. Payment will be due immediately upon our notification to you of the exact cost. If you choose this option, you will be given an additional 20 days, from the date the material is sent, for you to request a review as outlined in OPTION #2 below. You may wish

to give us additional written material for consideration in the review. Any additional information you wish to be considered should be submitted at the time you request a State Director Review or a National Director Review.

OPTION #2. This option allows you to request immediately a review of the decision by either the State Director or the National Director of Appeals. Should you choose the State Director, you will still be able to request a further review by the National Director of Appeals after the State Director's decision. If you choose the National Director, that decision will be administratively final and you will have no further appeal rights. If you do not check any materials, you should understand that no materials will be sent and the 45-day review period will begin with the receipt of your review request. However, if you do request materials, the 45 day review period will begin when FmHA sends you the materials.

You must notify the Area Supervisor of Appeals in writing within 30 calendar days of this decision letter, postmarked not later than April 4, 1992, regarding which of the above options you wish to request. Without such notification, your appeal will be deemed concluded.

Sincerely,

THOMAS W. ANTHONY, JR.
Hearing Officer

United States Department of Agriculture
Farmers Home Administration
December 3, 1991

Acro Corporation
Rt. 1 Box 228
Prairie Grove, AR 72753

Dear Acro Corporation:

After careful consideration, we are denying your request for leaseback. The specific reason(s) for our decision are:

You have not provided the information necessary to determine whether or not you could fulfill the terms or conditions of a lease (letter originally advising you of Homestead Protection and Leaseback/Buyback letters dated 08-23-91 and 09-12-91 requested information), procedural references 1951.911(a)(5)(i) and 1951.911(6).

A determination of not acting in good faith has been made regarding the issue of Basic Security not being properly accounted for. FmHA Instruction 1951.911(a)-(4)(i)(A) states if a Good Faith determination has already been made in connection with the borrower's/former borrower's request for primary servicing, such determination will be binding on the request for Leaseback/Buyback.

If you have any questions concerning the decision or the facts used in making our decision and desire further explanation, you may call or write the County Office at the address or phone number shown above to request a meeting with Lonnie D. Ewing within 15 calendar days of the date of this letter. You should present any new information or evidence along with possible alternatives for our consideration.

You may also bring a representative (or legal counsel) with you. You also have the right to appeal this decision to a hearing officer in lieu of, or in addition to, a meeting with the County Supervisor. See attachment for your appeal rights.

If you do not wish a meeting, as outlined above, a request for a hearing should be sent to the Area Supervisor, National Appeals Staff, Farmers Home Administration, Box 24, 7777 Walnut Grove, Suite OM 36, Memphis, Tennessee 38120, postmarked no later than January 3, 1992. Requests which are postmarked by the U. S. Postal Service on or before that date will be considered as timely received.

Sincerely,
LONNIE D. EWING
County Supervisor

United States Department of Agriculture
Farmers Home Administration
National Appeals Staff
June 8, 1990

#89022446 AR-FP
ACRO Corporation
Mr. Paul Schmidt
Route 1, Box 228
Prairie Grove, AR 72753
Dear Mr. Schmidt:

You requested an appeal of the decision by Farmers Home Administration (FmHA) on their intention to accelerate your loans for failure to properly account for the property used to secure your loan and for failure to

provide monthly cash flow statements. A hearing was held on the appeal request on May 15, 1990, in Fayetteville, Arkansas. Attending the hearing were: Elizabeth (Betsy) Wallace, Hearing Officer of FmHA's National Appeals Staff; yourself; Paul G. Schmidt, president of ACRO Corporation; Pauline D. Schmidt, secretary of ACRO Corporation; Steven D. Tennant, your attorney; and Lonnie D. Ewing, FmHA County Supervisor. The hearing was recorded by the Hearing Officer.

I have reviewed your appeal request, your case file, the hearing tape, and all relevant FmHA laws and regulations relating to your appeal. Based on this review, I have determined that FmHA's decision was correct. In regards to the issue of failure to properly account for property which served as security for your loan, the record shows that you did not receive written permission from FmHA prior to liquidating the herd of cattle. The sales provide an accounting of all cattle mortgaged to FmHA, as shown by the Security Agreement executed by ACRO Corporation and FmHA which was in affect the date the saie took place. You also testified that you did not advise FmHA of cattle deaths or of cattle that were lost or stolen as required by your loan agreement. Thus, FmHA's decision to advise you of their intent to accelerate your loans for failure to properly account for loan security is upheld.

In regards to the issue of failue to provide FmHA with monthly cash flow statements, the record shows that you provided in writing a statement agreeing to provide the monthly statements. Also, the case file indicates that FmHA gave you written notice on numerous occasions

that these cash flow statements were required and that you were not meeting this requirement. You did not provide evidence to verify that you had met this requirement. Thus, FmHA's decision to advise you of their intent to accelerate your loans for failure to provide requested financial information is upheld. Therefore, FmHA's decision is upheld.

If you feel that the above decision is incorrect and you wish further action to be taken, you have at this point in the appeal process two options available for your consideration:

OPTION #1. This option is designed to afford you an opportunity to review certain material from the hearing before you decide whether or not to request a review and if so, may give you guidance as to what kind of additional written material you might want to submit for consideration in the review. You may request a copy of the hearing tape and/or the written material from the hearing record. You may also request a written transcript of the tape, which is approximately $3.00 per page. If you choose this option, you will be given an additional 20 days from the date the material is sent for you to request a review as outlined in OPTION #2 below. You will be advised of this right again when the material is sent.

OPTION #2. This option allows you to immediately request a review of the decision by either the State Director or the National Director of Appeals. Should you choose the State Director, you will still be able to request a further review by the National Director of Appeals after the State Director's decision, should you desire. If you choose the National Director, that decision will be admin-

istratively final; and you will have no further appeal rights. If you choose this option, you will still be entitled to request the materials as outlined in OPTION #1 above. If you do not check any materials, you should understand that no materials will be sent and the 45-day review period will begin with the receipt of your review request. However, if you do request materials, you are advised that the 45 day review period will begin when FmHA sends you the materials.

Sincerely,

ELIZABETH (BETSY) WALLACE

Hearing Officer

APPEAL SUMMARY

8 9 0 2 2 4 4 6 AR-FP

Case #03-72-710451772

1. Appellant(s):

ACRO Corporation
Route 1, Box 401
Prairie Grove AR 72753
(501) 848-3540

Representative:

Steven Tennant
P. O. Box 120
Farmington AR 72730
(501) 267-2060

2. Type of appeal:

1951-S Notice of Intent to accelerate
(Non-monetary default)

3. Initial decision maker:

Lonnie D. Ewing
FmHA County Supervisor
Room 306 Federal Building

Original Servicing Office:

Same

35 E. Mountain
Fayetteville AR 72701
(501) 442-4295

4. Actions subsequent to this decision:

A. August 21, 1989
Southern Area Office received appeal request

B. October 17, 1989
Hearing Officer received designation

C. October 31, 1989
Hearing Officer acknowledged receipt of the appeal request and advised of the delay in scheduling due to the back log of appeal requests

D. December 15, 1989
Hearing date, time, and place confirmed

E. January 18, 1990
Appellant's representative requested rescheduling

F. April 12, 1990
Hearing date and time rescheduled

G. May 15, 1990
Hearing held

5. FmHA's reason(s) for adverse action:

1. Failure to account for security
2. Failure to provide previously requested cash flow statements

6. Appellant(s) reason(s) for appeal:

Believed they had accounted for all cattle that

were sold and contended that some cattle in question either died, ran off, or were stolen. Also contended that they attempted to supply financial information that was requested.

7. Has the correct appeal procedure been followed?

Yes, except that due to a back log of appeal requests, the hearing could not be held within 45 days of the receipt of the appeal request.

8. Is the decision consistent with FmHA policy, rules, regulations, and applicable laws? Yes

9. Appellant(s) FmHA history: As of 12/31/89

Loan Code	Date of Note	Original Amount	Approximate Balance	Amount of Delinquency
29-01	4/24/79	$384,000.00	$640,492.87	$271,536.00
44-02	2/21/80	90,000.00	95,866.61	95,866.61
44-95	8/24/89	6.00	6.22	6.22
44-96	1/25/83	3.00	5.18	5.18
29-97	10/19/82	130.00	209.56	209.56
Totals			$736,580.44	$367,623.57

10. Name, date, comments of person(s) contacted during review, or other source of material reviewed in reaching determination on appeal:

The appeal request, the case file, the hearing record, and FmHA Instructions 1951-S and 1962-A

11. Has the FmHA decision been factually refuted by the appellant? No.

12. Hearing Officer's conclusions and recommendations.

In accordance with FmHA Instruction 1951-S, FmHA issued 1951-S Exhibit A with Attachments 3 and 4 to ACRO Corporation for both monetary and non-monetary default. With the concurrence of the Regional Office of General Counsel, FmHA concluded that ACRO Corporation failed to act in good faith by converting or wasting the property mortgaged to FmHA.

The borrower, ACRO Corporation, obtained an operating loan February 21, 1980, in order to purchase cattle. The case file copy of the security agreement reflects 129 cows, 49 calves, 3 yearlings and 3 bulls. The running record of August 13, 1981, shows a chattel check by FmHA found 71 cows, 7 bulls, 52 calves and 11 steers. At this time Mr. Paul A. Schmidt advised the FmHA official that they had sold some cows to buy feed for the others. Mr. Schmidt also advised FmHA that 16 or 17 cows died while calving. Neither the sales or the deaths had been reported to FmHA as required by item III(B) of Form FmHA 440-4, Security Agreement, executed February 20, 1980. The case was submitted for legal action. ACRO Corporation made restitution to FmHA for 37 cows on January 3, 1983.

No security agreements were found in the case files for 1981 or 1982. The March 24, 1983, security agreement lists 74 cows, 7 bulls, 68 calves, 19 steers, and 6 heifers. There is no record of any approved disposition of cattle from the date of the initial loan through the execution of this security agreement. Form FmHA 462-1 does show that 37 cows were sold and 24 died. There is no

documentation as to whether the disposition was approved or disapproved. The running record of March 24, 1983, indicates that during a chattel inspection the borrowers were again advised that all security must be accounted for.

The security agreement executed on March 9, 1984, shows 4 bulls, 21 heifers, 70 cows, 15 steers, and 12 calves. There is no record in the case file of any request from ACRO Corporation for approval for the disposition of any cattle, yet the numbers were reduced as follows from the previous security agreement: 4 cows, 3 bulls, 41 calves, and 4 steers. Form FmHA 462-1, Record of The Disposition of Security Property, does indicate that these cattle had died from the winter and salmonella. Approval was given March 12, 1984, by the County Supervisor. The case file indicates that the borrower provided FmHA with evidence of only one dead calf, claiming the others had been buried. On March 13, 1984, one of the members of ACRO corporation signed Form FmHA 1924-14, Farmer Program Borrower Responsibilities, which informed the borrowers that they must not dispose of or give any additional liens on any FmHA security property without prior consent from the FmHA County Supervisor.

The Security agreement dated March 28, 1985, shows 3 bulls, 20 heifers, 62 cows, 19 steers and 19 calves. This reduces the numbers from the previous years agreement as follows: 1 bull, 1 heifer and 8 cows. There were 4 more steers and 7 additional calves from the previous agreement. Again there was no record of disposition found in the case file for the sale of calves nor cull cows. The running record of this date shows a chattel inspection

and that the borrower was advised to sell 1985 calf crop in the fall. A normal 80% calf crop would have produced 45 to 50 calves. The case file running record of August 20, 1985 shows that the Schmidts, in for an office visit, claimed they were still holding all steers which would be sold in the fall with all proceeds being applied to their FmHA debt.

A chattel inspection completed by the Assistant County Supervisor on January 7, 1986, revealed that ACRO Corporation had sold all cattle except 1 cow and 1 heifer on January 4, 1986. The borrower did not inform FmHA of this nor was prior approval obtained as required by their security agreement. During this inspection the borrower did present a check for the cattle that had been sold along with the sales barn record. It shows the sale of 39 cows, 27 calves weighing in excess of 700 pounds, 36 calves weighing less than 700 pounds, and 2 bulls for a total of 104 head. With the 2 head remaining on the farm added to the 104 head sold, a total of 106 head are accounted for. The security agreement in effect at the time of the sale indicates a total number of 123 head, leaving 17 head unaccounted for. Broken down by categories, the 20 heifers, 62 cows, 3 bulls, and 19 steers would have all weighed in excess of 700 pounds for a total of 104 head at the time of the sale. Yet the total on the sales barn ticket shows only 68 head in excess of 700 pounds. The case file does not show record of the disposition of any sales proceeds or the deaths of any calves or cull cows from the date of security agreement until the date of the sale. When the Hearing Officer questioned the borrower as to the present location of the 2 remaining

cattle, he stated 1 died and 1 ran off. When asked if he advised FmHA of this, he answered to the negative. Therefore it is the Hearing Officer's conclusion that there are at least 19 head of cattle unaccounted for.

A letter dated January 9, 1986, was issued to ACRO Corporation from FmHA advising them that they did not account for all cattle listed on the previous security agreement and demanding that they either pay FmHA the amount received from the sale of the property or replace with property of equal or greater value. The borrowers were advised of this again when FmHA issued Forms FmHA 1924-25, 1924-26, and 1924-14. In the appellants exhibit 1, a former attorney, Larry R. Froelich, explains in a letter dated March 14, 1986, that ACRO never understood that it was required to get advance approval to sell cattle. This statement is suspect because each security agreement executed by ACRO advised them of this. There is also reason to believe that when ACRO's account was submitted for legal action because of conversion, for which they made restitution in January 1983, FmHA would have advised ACRO or ACRO would have inquired as to what the proper procedure for disposition would have been, in order to protect themselves in the future. The previously mentioned letter also indicates that in a six year period at least 100 head of cattle died. This exceeds the normal expected mortality rate greatly. And it indicates that the only calves sold during the six year period were those sold January 4, 1986, when the herd was liquidated. Thus, one must question whether or not the farm management implemented proper animal husbandry practices in the care of the cattle. The letter

further states that there is no accurate way of telling how may cattle died, ran off, or were stolen.

FmHA An No. 2077 of FmHA Instruction 1951-S provides general guide lines for the determination of the lack of good faith because of fraud, waste, and conversion. Although there is no concrete evidence of the missing cattle being converted through sales, there is some evidence to conclude that there was lack of good faith because of waste. Waste is described as follows: (1) Unlawful act or omission on part of borrower, (2) Affects FmHA security, (3) Results in permanent injury to FmHA security, and (4) Borrower is in lawful possession of FmHA security. It further clarifies waste may be: (a) Active waste-intentional destruction of FmHA security, (b) Permissive waste allowing death, decay, deterioration, disrepair, or destruction of FmHA security through inexcusable neglect or negligence or (c) Equitable waste allowing death, decay, deterioration, disrepair, or destruction of FmHA security by not following management practices that a prudent person would have followed under similar circumstances. FmHA received concurrence on this bad faith determination from the Office of General Counsel, dated March 9, 1989. For these reasons, FmHA's decision to liquidate because of failure to properly account for security is upheld.

In regards to ACRO Corporations failure to provide monthly cash flow statements, on April 26, 1984, Mr. Paul G. Schmidt, Vice-President, provided a written statement to FmHA agreeing to provide these documents. FmHA requested this financial information again by letters dated April 15, 1985, May 10, 1985, August 15,

1985, and August 21, 1985. The case file also shows that this was discussed with the Schmidts during an office visit on August 20, 1985. The first record of any information being provided was May 1, 1985, which was a graft showing dollar amounts through the months of the year. Also some debit and credit figures were provided, but they did not present an accurate picture of where the money was coming from nor where or for what the expenses were being paid. These were not complete accurate records as required by FmHA regulations. ACRO Corporation's former attorney, on March 14, 1986, presented a more detailed financial statement beginning with October 1985. There is no other record of any attempt to provide these cash flow statements since March 1986. Thus, FmHA's determination of acting in bad faith for failing to provide monthly cash flow statements as agreed and requested is upheld.

It should be noted that FmHA Instruction 1951-S, 1951.909(C)(3) provides that all applications received from borrowers who apply for Primary Loan Servicing, even though they are not eligible, must be processed to determine whether or not a feasible plan of operation can be developed. It further provides that borrowers who do not meet the eligibility criteria must be processed in the same manner as a borrower who does not meet the feasibility requirements. As of yet, FmHA has not processed ACRO Corporation's application for Primary Loan Servicing.

United States Department of Agriculture
Farmers Home Administration
August 15, 1989

SUBJECT: The "Good Faith" Requirement of Section 1951.909(c)(2) of FmHA Instruction 1951-S, Acro Corporation, Washington County, Arkansas.

TO: County Supervisor, 03-72
Fayetteville, AR

Our Office of General Counsel has review the case and your documentation relative to the subject. It is their opinion that the materials submitted contains sufficient evidence to support a conclusion that Acro Corporation failed to act in good faith in its dealings with FmHA by converting or wasting the property mortgaged to the FmHA as security for its indebtedness. The file contains substantial evidence that the borrower either converted FmHA livestock security or permitted it to waste by allowing animals to die, run off or be stolen. The file does not contain substantial evidence of any mitigating circumstance, but is is possible that the borrower may present such evidence on appeal.

Remember, the decision regarding whether a borrower acted in good faith is made by you as County Supervisor. The decision is not OGC's responsibility.

The case file is returned, herein.

M. DUNAWAY
For ROBERT L. HANKINS
State Director

cc: District Director, 03-601

United States Department of Agriculture
Farmers Home Administration
January 9, 1986

Mr. and Mrs. Paul A. Schmidt
ACRO CORPORATION
Route 1, Box 228
Prairie Grove, AR 72753

Dear Mr. and Mrs. Schmidt:

It is our understanding that between March 28, 1985 and January 4, 1986, you sold the following described property:

23 cows, 1 Bull and 1 yearling heifer or steer

for an undetermined amount

Such property is covered by a financing statement and security agreement which secures your indebtedness owed to the Farmers Home Administration (FmHA).

Since you did not account for the proceeds in accordance with FmHA regulations and account for the cattle as listed on the last Security Agreement dated March 28, 1985, we demand that you either pay the FmHA the amount received or replace the property with property of equal or greater value.

If you are going to pay FmHA or replace the property with other property, please let FmHA know as soon as possible. if, instead, you believe you possess information that will show this demand was in error, you should contact the County Office at 442-4295 to arrange an appointment to discuss this matter and present such

information.

If you do not comply with this demand, we will recommend referral of this claim to the United States Attorney for appropriate action.

Sincerely,

LONNIE D. EWING

County Supervisor

STATUTES, RULES AND CONSTITUTIONAL PROVISIONS

Farmers Home Administration, USDA

Part 1951—Servicing and Collections

Subpart S—Farmer Programs Account Servicing Policies

§1951.911 Preservation loan service programs.

(a) *Leaseback/Buyback.*

(4) *Eligibility.* The County Supervisor will determine the applicant's eligibility.

(i) Any applicant for leaseback/buyback who either (1) first applied for primary servicing on or after November 28, 1990, or (2) first applied for leaseback/buyback on or after November 28, 1990, without first applying for primary servicing, and who is also the borrower/former owner, must have acted in good faith by demonstrating sincerity and honesty in meeting agreements set forth on Form FmHA 1962-1 and agreements with FmHA.

(A) If a good faith determination has already been made in connection with the borrower/former borrower's request for primary servicing of his or her loan pursuant to §1951.909(c)(2), such determination will be binding on the borrower/former borrower's request for leaseback/-

buyback. In such a case of a denial of leaseback/buyback when the borrower/former borrower had previously been denied primary loan servicing because of a determination that the borrower/former borrower had not acted in good faith, the denial of leaseback/buyback will not be appealable.

NOTE: A good faith determination made prior to November 28, 1990, for primary servicing, which was based on the sole fact that the borrower disposed of normal income security before October 14, 1988, without FmHA consent, and it has been determined the proceeds were used for essential household and farm operating expenses of which the borrower would have been entitled to a release of income proceeds in accordance with §1962.17(b)(2)(iii) and exhibit E of subpart A of part 1962 of this chapter, such good faith determination will not be binding for a leaseback/buyback application filed on or after November 28, 1990.

(B) If the borrower/former borrower had not previously been considered for primary servicing and no good faith determination had been previously made, then the County Supervisor will initially determine if the borrower/former borrower acted in good faith, using the criteria of §1951.909(c)(2). Disposal of normal income security prior to October 14, 1988, without FmHA's consent, will not constitute a lack of good faith if the proceeds were used to pay essential household and farm operating expenses and the borrower would have been entitled to a release of income proceeds in accordance with §1962.17(b)(2)(iii) and exhibit E of subpart A of part 1962 of this chapter.

(ii) Previous Owner. The individual(s) or entity that held title to the property at the time FmHA acquired the property. The previous owner, as an applicant for leaseback/buyback, may be an operator of larger than a family size farm and may be a different individual or entity than the former borrower.

(iii) Spouse and child(ren) of previous owner (if the previous owner was an individual). The spouse and/or any child(ren) who apply for leaseback/buyback must have been actively engaged in farming at the time of acquisition of the farm property. The applicant may be an operator of larger than a family size farm.

(iv) Entity members (if the previous owner was an entity), must be a member of the entity, held exclusively by members of the same family and must have been actively engaged in farming at the time of acquisition of the farm property. The applicant may be an operator of larger than a family size farm.

(v) Previous operator must have been the operator (lessee) of the farm property at the time FmHA acquired the farm property from the former owner (lessor) and be an operator or not larger than a family size farm after execution of any lease or purchase agreement. The applicant does not need to be an FmHA borrower.

(vi) All applicants must meet the application requirements of §1951.911(a)(3) of this subpart.

(vii) If the County Supervisor determines the applicant is not eligible for leaseback/buyback, the applicant will be advised of appeal rights in accordance with subpart B of part 1900 of this chapter.

United States Constitution

Amendment V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a grand jury, except in cases arising in the land or naval forces, or in the militia, when in actual service in time of war or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Amendment XIV, Section 1

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the state wherein they reside. No state shall make or enforce any law which shall abridge the privileges and immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Response to Notice

Application received 4/21/89

Response to Notice Informing Me of FmHA's Intent to Accelerate My Loan

Notice of My Rights

To: County Supervisor, Farmers Home Administration

From: Paul A. Schmidt & Pauline B. Schmidt

I have read the notice informing me of FmHA's intent to accelerate my loan which I received with this form.

I want to:

1. Request a meeting with FmHA County Office. My phone number is _____.
   I must return this form in *15 days.*
   I understand I do not lose my right to appeal by asking for a meeting.
2. Be considered for *all* primary and preservation loan programs.
   I must return this form in *45 days.*
3. Have an administrative appeal hearing. I understand that I will be contacted by FmHA's National Appeals Staff to set up the appeal hearing date and give more information. I must return this form in *30 days.*

Date: 3/10/89

PAUL A. SCHMIDT

PAULINE B. SCHMIDT